Universiteit Leiden
The Netherlands

Intra-group financing and enterprise group insolvency: problems, principles and solutions

Kokorin, I.

Citation
Kokorin, I. (2023, November 14). *Intra-group financing and enterprise group insolvency: problems, principles and solutions*. *Meijers-reeks*. Retrieved from https://hdl.handle.net/1887/3663098

Version:	Publisher's Version
License:	Licence agreement concerning inclusion of doctoral thesis in the Institutional Repository of the University of Leiden
Downloaded from:	https://hdl.handle.net/1887/3663098

Note: To cite this publication please use the final published version (if applicable).

E.M. MEIJERS INSTITUUT

INSTITUUT VOOR RECHTSWETENSCHAPPELIJK ONDERZOEK

Intra-Group Financing and Enterprise Group Insolvency

Problems, principles and solutions

I. KOKORIN

Intra-group financing and enterprise group insolvency:
Problems, principles and solutions

Intra-group financing and enterprise group insolvency

Problems, principles and solutions

PROEFSCHRIFT

ter verkrijging van
de graad van doctor aan de Universiteit Leiden,
op gezag van rector magnificus prof.dr.ir. H. Bijl,
volgens besluit van het college voor promoties
te verdedigen op dinsdag 14 november 2023
klokke 16.15 uur

door

Ilya Kokorin

geboren te Krasnoyarsk-26, Unie van Socialistische Sovjetrepublieken

in 1987

Promotoren: prof. dr. M. Haentjens
prof. dr. R.D. Vriesendorp

Promotiecommissie: prof. dr. H. Koster
prof. dr. W.A.K. Rank
prof. dr. I. Mevorach (The University of Warwick, UK)
prof. dr. G.R. Warner (St. John's University, USA)
prof. dr. P.M. Veder (Radboud Universiteit)

Lay-out: AlphaZet prepress, Bodegraven
Printwerk: Ipskamp Printing

© 2023 I. Kokorin

Behoudens de in of krachtens de Auteurswet van 1912 gestelde uitzonderingen mag niets uit deze uitgave worden verveelvoudigd, opgeslagen in een geautomatiseerd gegevensbestand of openbaar gemaakt, in enige vorm of op enige wijze, hetzij elektronisch, mechanisch, door fotokopieën, opnamen of enig andere manier, zonder voorafgaande schriftelijke toestemming van de auteur.

No part of this book may be reproduced in any form, by print, photoprint, microfilm or any other means without written permission of the author.

Acknowledgements

This book is the result of a long and exciting journey – a journey of constant learning and development. I am grateful to the many people who have supported and guided me in my academic and professional pursuits. Without them, this book would not have been possible.

I began my legal career in a small law firm in the Siberian city of Tomsk, three thousand kilometres east of Moscow, at the end of 2008. This was right at the time when the global financial crisis reached Russia, causing many firms to go out of business. It marked my initial encounter with the rapidly evolving field of insolvency law. In 2012, after obtaining an LLM degree from Central European University (Hungary), I relocated to Saint Petersburg. There, I joined the dispute resolution and insolvency groups of international law firms. Being a member of a team solving complex legal and practical problems was truly fulfilling. I am thankful to all practicing lawyers who shared their knowledge with me. The hands-on experience in the field ignited a deeper, more theoretical interest in insolvency law. This interest was further fuelled during my studies at Leiden University (2014-2015), where I met some of the greatest teachers and researchers. It was also at this prestigious, the Netherlands' oldest, university that I set foot on my academic path in 2017.

My first words of gratitude go to my supervisors, Matthias Haentjens and Reinout Vriesendorp. These two individuals played an important role in the success of the entire PhD endeavour. They provided me with unwavering support and the flexibility to explore new ideas and engage in various projects. I would like to express my appreciation to Stichting Hazelhoff Van Huet and the Meijers Research Institute, who generously co-funded my 4-year PhD position. Many thanks also extend to the doctoral committee members, who took their time to read my (rather lengthy) PhD thesis and share their insightful comments and questions. Thank you, Professors Harold Koster, Pim Rank, Irit Mevorach, Ray Warner, Michael Veder, Branda Katan and Bob Wessels.

I was once told that doing a PhD is a lonely journey. However, I consider myself fortunate to have crossed paths with remarkable people who made my PhD life much more enjoyable. I was lucky to have met Prof. Bob Wessels, who, over the past few years, has become a good friend and ally. Bob is simply amazing. With him, I have co-authored two books, numerous

articles, and blogs. I have also collaborated with other outstanding scholars, including Irit Mevorach, Stephan Madaus, Tycho de Graaf, Matthias Haentjens, Gert-Jan Boon, Jeroen van der Weide, Bilal Kurbanov, Jaap Baaij, Vasile Rotaru and Morshed Mannan. I am indebted to Prof. Ray Warner, who warmly welcomed me to St. John's University during my research stay in April 2022. I will always cherish the countless hours spent with him discussing the complexities of US bankruptcy law. I greatly benefitted from a research visit to the Commercial Law Centre at Harris Manchester College, University of Oxford, in the fall of 2021. My sincere thanks go to Prof. Kristin van Zwieten for facilitating this research visit, even during the challenging times of the coronavirus pandemic.

I wish to express my thanks to Iris Wuisman and Reinout Vriesendorp, who first invited me to work in Leiden in 2017. My appreciation also goes to Pim Rank and Matthias Haentjens for welcoming me into the family of the Hazelhoff Centre for Financial Law in 2019. I am grateful to both my current and former colleagues at Leiden University for fostering a safe, fun, and intellectually stimulating work environment. I would like to extend special thanks to Jacqueline Wessel for always being there for me.

My PhD life has been enriched through the participation in scientific conferences and various activities organised by INSOL Europe, INSOL International, European Banking Institute, Oxford Digital Assets Project, International Insolvency Institute, Conference on European Restructuring and Insolvency Law, and several other initiatives. Being a part of the insolvency, company and financial law communities has allowed me to share my research, receive valuable feedback and get to know many brilliant scholars all over the world. A big thanks also goes to my friends, including my paranymphs, Daniël Stein and Gert-Jan Boon, whose encouragement, help, and critical views are always appreciated.

Last but certainly not least, I owe a tremendous debt of gratitude to my family, without whom this journey would not have even begun. My parents, Vladimir and Natalia, have always believed in me and invested in my growth, from my early English language classes in Siberia, to my education in Tomsk and multiple ventures abroad. It is because of their unconditional love and support that I achieve this milestone. *Спасибо вам за все, люблю и ценю вас! (Thank you for everything; I love and deeply value you!).*

Ilya Kokorin
Leiden, September 2023

Table of Contents

Acknowledgements V

List of Abbreviations XIII

Part I Introduction 1

1 What this Book is About 3
1.1 Setting the Scene 3
1.1.1 Lehman Brothers 3
1.1.2 Nortel Networks 8
1.1.3 Oi Brazil 12
1.1.4 Common features of group insolvencies 16
1.2 Main Question 17
1.3 Scope and Aims of This Book 21
1.4 Organisation of This Book 27

Part II Enterprise Groups: Their Life and Death 31

2 Phenomenon and Rise of Multinational Enterprise Groups 33
2.1 Introduction 33
2.2 History and Legal Foundations of Enterprise Groups 34
2.3 Defining an Enterprise Group 41
2.4 Characteristics and Types of Enterprise Groups 45
2.5 Enterprise Groups and the Curious Case of Limited Liability 48
2.6 Conclusion 54

3 Enterprise Groups and Insolvency Law 57
3.1 Introduction 57
3.2 Three Generations of Insolvency Law 59
3.3 Three Restructuring Procedures 64
3.3.1 The UK: schemes of arrangement 64
3.3.2 The USA: Chapter 11 of the US Bankruptcy Code 66
3.3.3 The Netherlands: WHOA schemes 70
3.4 From a Single Entity to a Single Enterprise? 72
3.4.1 Why recognition of enterprise groups in insolvency law took so long 72

3.4.2 The Global Financial Crisis as an accelerator of change 75
3.4.3 The rise of the rescue culture 77
3.5 Limits of a Single Enterprise Approach 80
3.5.1 Limits of group resolvability 80
3.5.2 Limits of a group-centric vision in corporate insolvency law 82
3.6 Conclusion 84

Part III Principles of Insolvency Law and How to Balance Them 87

4 Principles of Insolvency Law and Principle-based Approach 89
4.1 Introduction 89
4.2 Defining a Legal Principle 91
4.3 Core Legal Principles at Play in Insolvency 94
4.3.1 Classification of legal principles 94
4.3.2 Principles of insolvency law v. principles of restructuring law 95
4.3.3 Value preservation and maximisation 97
4.3.4 Protection of legitimate expectations, freedom of contract and party autonomy 102
4.3.5 Equal treatment of creditors 107
4.4 Application of Legal Principles in Group Insolvencies 111
4.4.1 Value preservation and maximisation within enterprise groups 111
4.4.2 Legitimate expectations and group reality 113
4.4.3 Explicit and hidden priorities in group insolvencies 114
4.5 Conclusion 116

5 Collision of Legal Principles and How to Resolve it 117
5.1 Introduction 117
5.2 The Notion of Fairness in Insolvency Law 118
5.3 Weight of Legal Principles 122
5.4 Meta-Principles 124
5.4.1 Optimisation: Pareto and Kaldor-Hicks efficiency 124
5.4.2 Consistency: alike and unalike cases 125
5.4.3 Proportionality: key tool in a balancing exercise 126
5.5 Conclusion 128

Part IV Intra-Group Financing and Insolvency: Transactions and Problems 131

6 Cross-guarantees, Recourse Claims and "Orphan Restructurings" 133
6.1 Introduction 133

6.2 Cross-guarantees and Co-debtorship Arrangements 134
6.3 How Do Cross-guarantees Work? 135
6.4 Functions of Cross-guarantees 138
6.4.1 "Protective" function of cross-guarantees 138
6.4.2 "Opportunistic" function of cross-guarantees 141
6.5 Insolvency and Triangle of Rights and Liabilities: Principal Debtor, Creditor and Guarantor 143
6.5.1 Cross-guarantees and insolvency: important questions 143
6.5.2 Insolvency of the principal debtor and claim against a guarantor 145
6.5.3 Performance by a guarantor and its rights against the principal debtor 160
6.6 Insolvency and Ex-post Effects of Cross-guarantees 172
6.7 Conclusion 175

7 Intra-group Loans and Statutory Subordination 177
7.1 Introduction 177
7.2 Intra-group Loans and Centralised Cash Management 179
7.3 Internal v. External Creditor Divide 181
7.3.1 Information asymmetry 181
7.3.2 Power and control 182
7.3.3 Risk appetite and misalignment of incentives 183
7.3.4 Minimum capital requirements and capital maintenance 184
7.4 Subordination of Shareholder Loans: National Perspectives 185
7.4.1 Contractual v. statutory subordination 185
7.4.2 The UK: subordination for claims of shareholders *qua* shareholders 187
7.4.3 The USA: Equitable subordination and debt recharacterization 190
7.4.4 The Netherlands: conflicting authorities 198
7.5 Shareholder Loans: to Subordinate or not to Subordinate? 201
7.5.1 Facilitation of early insolvency filings 201
7.5.2 Responsibility for consequences of financial decisions 203
7.5.3 Risk re-allocation and risk shifting 204
7.5.4 Value-enhancing and value-destroying rescue attempts 207
7.6 Conclusion 211

8 Facing Uncertainty: Intra-group Financing and Transaction Avoidance 213
8.1 Introduction 213
8.2 "Group Considerations" in Insolvency Transaction Avoidance 215
8.2.1 Transaction avoidance and group specificity 215

8.2.2 The UK: measuring the value for the creditor and guarantor 218
8.2.3 The USA: in search for future and indirect benefits 223
8.2.4 The Netherlands: *Faillissementspauliana* 229
8.3 Difficulties of Ex Post Substantive Review 235
8.4 Conclusion 239

9 When Insolvency meets Freedom of Contract: Ipso Facto and Cross-default Clauses 241
9.1 Introduction 241
9.2 Ipso Facto and Cross-Default Clauses: Definition and Rationale 242
9.2.1 Ipso facto clauses 242
9.2.2 Cross-default clauses 245
9.3 Enforceability of Ipso Facto Clauses 247
9.3.1 The UK: contracts for supply of goods or services 247
9.3.2 The USA: executory contracts and safe harbours 250
9.3.3 The Netherlands: WHOA schemes and obligations towards debtors 256
9.3.4 International developments 260
9.4 Enforceability of Cross-Default Clauses in Insolvency 262
9.4.1 The UK: suspension of termination rights during "insolvency period" 262
9.4.2 The USA: contract assumption and de-acceleration 265
9.4.3 The Netherlands: suspension of termination rights during "cooling-off period" 270
9.5 Insolvency and Ex-post Effects of Ipso Facto and Cross-Default Clauses in a Group Context 273
9.6 Conclusion 274

Part V Group-sensitive Insolvency Law: Tools and Solutions 277

10 Group Debt Deleveraging and Debt Adjustment: Third-party Releases 279
10.1 Introduction 279
10.2 Third-Party Releases 280
10.2.1 Rationale of third-party releases 280
10.2.2 The UK: third-party releases in schemes of arrangement 283
10.2.3 The USA: third-party releases in Chapter 11 289
10.2.4 The Netherlands: third-party releases in WHOA schemes 293
10.3 Conclusions and Suggestions 306
10.3.1 Overview of main findings 306
10.3.2 Suggestions on third-party releases in a group context 308

11 Insolvency Stay on Creditor Action and its Extension to Group Entities 313
11.1 Introduction 313
11.2 Enforcement Stays in National Law 315
11.2.1 The UK: patchwork of different rules and procedures 315
11.2.2 The USA: broad automatic and worldwide stay 319
11.2.3 The Netherlands: moratoriums and cooling-off periods 323
11.2.4 Summary of national law approaches 327
11.3 Extension of an Enforcement Stay to Group Entities 329
11.3.1 A stay and group insolvency 329
11.3.2 The USA: limited possibility of a stay extension 331
11.3.3 The Netherlands: extension of a stay to group entities 334
11.4 Conclusions and Suggestions 335
11.4.1 Overview of main findings 335
11.4.2 Suggestions on the extension of a stay to group entities 337

12 Intra-group Rescue Financing: Safe Harbours and Pre-emptive Strategies 341
12.1 Introduction 341
12.2 Ex Ante Approval Mechanisms and Safe Harbours 343
12.2.1 Three types of safe harbours 343
12.2.2 The Netherlands: safe harbour under the WHOA 345
12.2.3 The USA: DIP financing as a group effort 348
12.3 Pre-emptive Financial Arrangements in Banking Groups 353
12.3.1 Bank resolution: from reaction to pre-emption 353
12.3.2 Group financial support agreements under the BRRD 355
12.3.3 Prepositioning of loss absorbing capacity within banking groups 359
12.3.4 Structural and contractual arrangements related to intra-group support 361
12.4 Conclusions and Suggestions 364
12.4.1 Overview of main findings 364
12.4.2 Suggestions on dealing with intra-group rescue financing 366

13 Limits of Freedom of Contract: Ipso Facto and Cross-default Clauses in a Group Context 371
13.1 Introduction 371
13.2 Ipso Facto Clauses in a Group Insolvency Context 372
13.2.1 Determining the scope of inquiry: three scenarios 372
13.2.2 The UK and the Netherlands: application to direct counterparties 374
13.2.3 The USA: expansive interpretation of law 376
13.2.4 The BRRD and unenforceability of cross-entity ipso facto clauses 381

13.3 Cross-defaults in a Group Insolvency Context 384
13.3.1 Suspension of default-related rights 384
13.3.2 Neutralisation of intercompany cross-defaults in a restructuring plan 386
13.3.3 Assumption, deacceleration and substantially unrelated contracts 388
13.4 Conclusions and Suggestions 391
13.4.1 Overview of main findings 391
13.4.2 Suggestions on intercompany ipso facto clauses 393
13.4.3 Suggestions on intercompany cross-default clauses 395

Part VI Conclusion 397

14 Key Findings and Observations 399
14.1 Forces of Change and Group Insolvencies 399
14.2 Revealing the Trunk and Branches behind the Leaves 400
14.3 Intra-group Financing and Group Insolvency: Challenges and Solutions 402
14.3.1 Group economic and legal realities 402
14.3.2 "Extension effect" in insolvency law 404
14.4 Key Observations: Guiding Factors 408
14.4.1 In search for guiding factors 408
14.4.2 Group integration and interdependence 408
14.4.3 Financial situation of non-debtor group entities 409
14.4.4 Purpose and nature of the procedure 410
14.4.5 Prevalence of public interest 412

Annex Summary of Problems and Solutions 415

Bibliography 417

Summary 445

Samenvatting (Summary in Dutch) 453

Curriculum Vitae 461

List of Abbreviations

ABI	American Bankruptcy Institute
AktG	*Aktiengesetz* (German), German Stock Corporation Act
ALI	American Law Institute
APR	Absolute priority rule
Art.	Article
AT&T	American Telephone and Telegraph Company
BCBS	Basel Committee on Banking Supervision
BGH	*Bundesgerichtshof* (German), German Federal Court of Justice
B.R.	Bankruptcy Reporter
BRRD	Bank Recovery and Resolution Directive, Directive 2014/59/EU of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms
BW	*Burgerlijk Wetboek* (Dutch), Dutch Civil Code
CCAA	Companies' Creditors Arrangement Act (Canada)
CEO	Chief executive officer
CERIL	Conference on European Restructuring and Insolvency Law
CIGA	Corporate Insolvency and Governance Act 2020 (UK)
Cir.	Circuit
CIWUD	Directive 2001/24/EC of 4 April 2001 on the reorganisation and winding up of credit institutions
CJEU	Court of Justice of the European Union
CNA	Citicorp North America
COMI	Centre of main interests
Coop	Oi Brasil Holdings Coöperatief U.A.
CPR	Civil Procedure Rules (UK)
CUP	Cambridge University Press
CVA	Company voluntary arrangement
DAO	Decentralised autonomous organisation
DCC	Dutch Civil Code
DCFR	Draft Common Frame of Reference
DIP	Debtor in possession
EBA	European Banking Authority
EBOR	European Business Organization Law Review
EBRD	European Bank for Reconstruction and Development
EC	European Commission
ECB	European Central Bank
ECFR	European Company and Financial Law Review
ECGI	European Corporate Governance Institute
ECHR	European Convention on Human Rights

ECtHR	European Court of Human Rights
EFTA	European Free Trade Association
e.g.	*exempli gratia* (for example)
EIC	English East India Company
EIR 2000	Council Regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings
EIR Recast	Regulation (EU) 2015/848 of 20 May 2015 on insolvency proceedings (recast)
EKEG	*Bundesgesetz, mit dem ein Bundesgesetz über Eigenkapital ersetzende Gesellschafterleistungen (Eigenkapitalersatz-Gesetz – EKEG)* (German), Austrian Equity Substitution Act (Austria)
EU	European Union
EUR	Euro
EWCA	England and Wales Court of Appeal (UK)
FDIA	Federal Deposit Insurance Act (USA)
FDIC	Federal Deposit Insurance Corporation
FSB	Financial Stability Board
Fw	*Faillissementswet* (Dutch), Dutch Bankruptcy Act
GFC	Global Financial Crisis
GFSA	Group financial support agreement
GMRA	Global Master Repurchase Agreement
G-SIB	Global systemically important bank
HR	*Hoge Raad* (Dutch), Dutch Supreme Court
HUP	Harvard University Press
IAIS	International Association of Insurance Supervisors
ibid.	*ibidem* (in the same place)
i.e.	*id est* (in other words)
IHC	Intermediate holding company
III	International Insolvency Institute
InsO	*Insolvenzordnung* (German), German Insolvency Code
IOSCO	International Organization of Securities Commissions
IP	Insolvency practitioner
IRDA	Insolvency, Restructuring and Dissolution Act (Singapore)
ISDA	International Swaps and Derivatives Association
IT	Information technology
IVA	Individual voluntary arrangement
JOR	*Jurisprudentie Onderneming & Recht* (Dutch), Jurisprudence Business & Law
KA	Key Attribute
LBHI	Lehman Brothers Holdings, Inc.
LBT	Lehman Brothers Treasury Co B.V.
LMA	Loan Market Association
MEG	Multinational enterprise group
MLCBI	UNCITRAL Model Law on Cross-Border Insolvency
MLEGI	UNCITRAL Model Law on Enterprise Group Insolvency
MPOE	Multiple point of entry

MREL	Minimum requirement for own funds and eligible liabilities
MSME	Micro, small and medium-sized enterprise
NACIIL	*Nederlandse Vereniging voor Rechtsvergelijkend en Internationaal Insolventierecht* (Dutch), Netherlands Association for Comparative and International Insolvency Law
NCWO	No-creditor-worse-off
NJ	*Nederlandse Jurisprudentie* (Dutch), reports of court decisions (Netherlands)
NPV	Net present value
OUP	Oxford University Press
PECL	Principles of European Contract Law
PTIF	Portugal Telecom International Finance B.V.
R&D	Research and development
ReO	*Restrukturierungsordnung* (German), Restructuring Regulation (Austria)
Rb.	*Rechtbank* (Dutch), first instance court (Netherlands)
RPT	Related party transaction
SME	Small and medium-sized enterprise
SNFE	Significant non-financial enterprise
SPOE	Single point of entry
SPE	Special purpose entity
SPV	Special purpose vehicle
SRB	Single Resolution Board
SRMR	Single Resolution Mechanism Regulation, Regulation (EU) No 806/2014 of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund
SSA	Secured support agreement
StaRUG	*Gesetz über den Stabilisierungs- und Restrukturierungsrahmen für Unternehmen (Unternehmensstabilisierungs- und -restrukturierungsgesetz – StaRUG)* (German), Enterprise Stabilization and Restructuring Act (Germany)
TLAC	Total loss-absorbing capacity
UCC	Uniform Commercial Code
UK	United Kingdom of Great Britain and Northern Ireland
UKSC	United Kingdom Supreme Court
UNCITRAL	United Nations Commission on International Trade Law
USA/US	United States of America
USD	US dollar
VOC	*Vereenigde Oostindische Compagnie* (Dutch), Dutch East India Company
Vol.	Volume
WHOA	*Wet Homologatie Onderhands Akkoord* (Dutch), Act on Court Confirmation of Extrajudicial Restructuring Plans (Netherlands)

Part I

Introduction

1 What this Book is About

1.1 Setting the Scene

This book is about certain financial transactions, enterprise groups and their interaction with insolvency law. Yet before diving into this interesting but complex interaction, to set the tone for the rest of the book and to provide a general background against which the legal issues will be analysed, we introduce three "benchmark" cases. These cases recount the collapses of major multinational enterprise groups – Lehman Brothers, Nortel Networks, and Oi Brazil. Each case underscores some distinct features that set them apart from "simple" single-debtor bankruptcies. Our choice of these cases has been determined by their international character, large scale, involvement of multiple stakeholders, and complex webs of intra-group financial arrangements. These characteristics make a group-wide resolution of financial problems more challenging but at the same time more desirable or even necessary to preserve and maximise value.

1.1.1 Lehman Brothers

The colossal failure of Lehman Brothers needs no introduction. For the most of its lifespan, Lehman Brothers existed in the form of a partnership. Founded in 1859, it engaged in the trading of retail goods and commodities. Gradually, Lehman Brothers was transformed into an investment bank. In 1984, it was sold to American Express, that merged it with its financial subsidiary to become Shearson Lehman Brothers. As a result, Lehman Brothers became a wholly owned subsidiary of American Express, losing its partnership status but preserving its 134-year-old name. The merger turned out to be short-lived. In the 1990s, American Express began to divest itself of the financial services business. In 1994, Lehman Brothers was spun off in an initial public offering as Lehman Brothers Holdings, Inc. (LBHI).

Over the 2000s, Lehman Brothers expanded its portfolio of services and pursued business opportunities in proprietary trading, derivatives, asset management, securitisation, and real estate.[1] As part of this expansion, the firm transitioned from a relatively low-risk brokerage model to a high-risk,

1 R.Z. Wiggins, T. Piontek, A. Metrick, The Lehman Brothers Bankruptcy A: Overview, Journal of Financial Crises, Vol. 1, 2019, p. 43.

capital-intensive banking model, especially with proprietary investments in commercial real estate, leveraged loans, and private equity.[2] This crucial change in the business model rewarded excessive risk taking and leverage. It also made Lehman Brothers dependent on the confidence of its counterparties, which quickly evaporated when the value of mortgaged-backed securities – the primary assets held by Lehman's corporate group and used as collateral for its credit lines – sharply declined in the course of 2007-2008. Unable to secure government funding or find a private solution, LBHI and its subsidiaries filed voluntary Chapter 11 petitions in the United States Bankruptcy Court for the Southern District of New York on 15 September 2008, listing liabilities exceeding USD 600 billion.[3] At that time, Lehman Brothers was the fourth largest investment bank in the USA and one of the largest financial services firms in the world.

The bankruptcy of Lehman Brothers proved to be a long-lasting battle. The court documents indicate that "[t]he chaos that ensued was unprecedented and presented the potential for highly fractious proceedings permeated by years of extended, complex and expensive litigation among competing interests and entities."[4] One of the main reasons for this complexity relates to the group's organisational and financial structure.

Lehman Brothers' worldwide headquarters in New York and regional headquarters in London and Tokyo were complemented by a network of offices spanning North America, Europe, the Middle East, Latin America and the Asia Pacific region.[5] The Lehman Brothers group consisted of 2,985 legal entities operating in some 50 countries.[6] Pistor describes the structure of Lehman Brothers as follows:

> Lehman Brothers […] developed the legal partitioning of assets with the help of corporate law into an art form. The business operated as a fully integrated global financial services provider, but its operations, liabilities, and profit centers were divided among hundreds of legal entities.[7]

---

2 For an overview of the Lehman Brothers' history and reasons of its bankruptcy, see A.R. Valukas, R.L. Byman, D.R. Murray, The Rise and Fall of Lehman Brothers, in D. Faber and N. Vermunt (eds), Bank Failure: Lessons from Lehman Brothers, OUP, 2017, paras. 1.01-1.83; S.J. Lubben and S.P. Woo, Reconceptualizing Lehman, Texas International Law Journal, Vol. 49, 2014, pp. 295-325.

3 Lehman Brothers Holdings Inc. (Chapter 11) <https://dm.epiq11.com/case/lehman/info> (accessed 27 July 2023).

4 Debtors' Amended Response to Objections to Approval of Proposed Disclosure Statement, *In re Lehman Bros. Holdings*, No. 08-13555 (Bankr. S.D.N.Y. 23 August 2011).

5 Lehman Brothers Holdings Inc. Form 10-K for fiscal year ended November 30, 2007.

6 BCBS, Report and Recommendations of the Cross-Border Bank Resolution Group, March 2010, para. 49.

7 K. Pistor, The Code of Capital: How the Law Creates Wealth and Inequality, Princeton University Press, 2019, p. 54.

Corporate complexity made the implementation of an orderly resolution difficult. The collapse of the enterprise group resulted in over 75 separate proceedings worldwide and more than 16 official representatives appointed.[8] Not only were the proceedings separated by geographical lines. The legal boundaries were perhaps even more significant. While US law applied to the proceedings opened against LBHI and its US subsidiaries, insolvency laws of more than 80 jurisdictions applied to non-US Lehman Brothers entities.[9] This legal fragmentation at times led to irreconcilable judgments.[10] Writing on the Lehman's intra-group operations, the Basel Committee on Banking Supervision (BCBS), the primary global standard setter for prudential regulation of banks, observes that:

> The flexibility of the organisation was such that a trade performed in one company could be booked in another. The lines of business did not necessarily map to the legal entity lines of the companies. The group was organised so that some essential functions, including the management of liquidity, were centralised in LBHI.[11]

The Lehman Brothers group acted as an integrated global enterprise. Its corporate structure was designed to optimise economic returns to the whole group. The vast majority of LBHI's subsidiaries were not designed to act as standalone legal entities and instead in many cases they were incorporated as special purpose vehicle supporting core operating companies. For example, the Dutch entity, Lehman Brothers Treasury Co B.V. (LBT), functioned as a financing company, issuing notes to both professional and retail investors and on-lending the proceeds to finance the group's activities. Obligations under these notes were guaranteed by LBHI and hedged by other group members (e.g. Lehman Brothers Special Finance Inc.). Consequently, in the bankruptcy of LBHI, two types of claims were filed: (i) LBT's direct intercompany claim, and (ii) claims of noteholders based on the cross-guarantee. Initially, LBHI dismissed the LBT's claim in its entirety, citing concerns that it might lead to a double recovery by LBT's noteholders. Subsequently, after rounds of negotiations between Dutch and US parties, a settlement was eventually reached. According to it, the LBT's intercompany claim was recognised, while some distributions by LBHI on

---

8 J. Altman, A Test Case in International Bankruptcy Protocols: The Lehman Brothers Insolvency, San Diego International Law Journal, Vol. 12, 2011, p. 464.

9 M.J. Fleming and A. Sarkar, The Failure Resolution of Lehman Brothers, Federal Reserve Bank of New York Economic Policy Review, Vol. 20, 2014 <https://www.newyorkfed.org/research/epr/2014/1412flem.html> (accessed 21 July 2023).

10 A.V. Sexton, Current Problems and Trends in the Administration of Transnational Insolvencies Involving Enterprise Groups: the Mixed Record of Protocols, the UNCITRAL Model Insolvency Law, and the EU Insolvency Regulation, Chicago Journal of International Law, Vol. 12, 2012, p. 815.

11 BCBS, Report and Recommendations of the Cross-Border Bank Resolution Group, March 2010, para. 50.

LBT guarantee claims were to be re-allocated to holders of unsecured claims against LBHI.[12]

As indicated by the LBT's bankruptcy trustees, "LBT was incorporated solely for serving the financing needs of [LBHI] and other entities of the Lehman Brothers Group. […] So, economic dependency was a characteristic of LBT. It was not meant to be a[n] autonomous business entity."[13] Another important member of the Lehman Brothers' "family" was Lehman Brothers International (Europe) (LBIE), headquartered in London. LBIE played a pivotal role as the group's main European hub, placing the notes on the market and keeping books and records for other subsidiaries, including LBT (section 4.4.1.). Not only was this internal group hierarchy opaque to outsiders, but even some of Lehman's employees were not aware of the distinction between various group entities or the specific entity that employed them.[14]

The integrated character of the Lehman Brothers group was evident in the way it organised its finances. It had a centralised cash management system, within which LBHI acted as a banker for hundreds of its subsidiaries, some of which could not function without cash transfers from LBHI to fund their operations. According to the report of the LBHI's examiner, Anton R. Valukas ("Valukas Report"), LBHI controlled the "cash disbursements and receivables for itself, its subsidiaries and its affiliates."[15] This system was designed to track all cash activities, maximise investment opportunities and minimise transaction costs, including funding, capital and tax costs. As a holding company, LBHI lent money to its operating subsidiaries "at the beginning of each day and then swept the cash back to LBHI at the end of each day."[16] In other words, it ran a zero-balance cash management or cash pooling system.

---

12 Modified Third Amended Joint Chapter 11 Plan of Lehman Brothers Holdings Inc. and its Affiliated Debtors, dated December 5, 2011 <https://portal-redirect.epiq11.com/LBH/document/GetDocument.aspx?DocumentId=1456969> (accessed 21 July 2023). The plan was confirmed by the court on 6 December 2011.

13 R. Schimmelpenninck, F. Verhoeven, Investigation of the causes of the bankruptcy of Lehman Brothers Treasury Co B.V., Amsterdam, 1 March 2013.

14 J. Carmassi and R.J. Herring, Corporate Complexity and Systemic Risk: A Progress Report, in A.N. Berger, P. Molyneux and J.O.S. Wilson (eds), The Oxford Handbook of Banking, OUP, 3rd edn, 2019, p. 98; C. Cumming, R.A. Eisenbeis, Resolving Troubled Systemically Important Cross-Border Financial Institutions: Is a New Corporate Organizational Form Required? Federal Reserve Bank of New York, Staff Report No. 457, 2010 <https://www.newyorkfed.org/research/staff_reports/sr457.html> (accessed 21 July 2023), observing that the Lehman' legal structure "was essentially unrelated to either its operational structure or the lines of business in which the organization engaged."

15 Lehman Brothers Holdings Inc. Chapter 11 Proceedings Examiner's Report (Valukas Report), 2010, p. 1550.

16 R.J. Herring and J. Carmassi, The Corporate Structure of International Financial Conglomerates: Complexity and its Implications for Safety and Soundness, in A.N. Berger, P. Molyneux, J.O.S. Wilson (eds), The Oxford Handbook on Banking, OUP, 1st edn, 2012, p. 225.

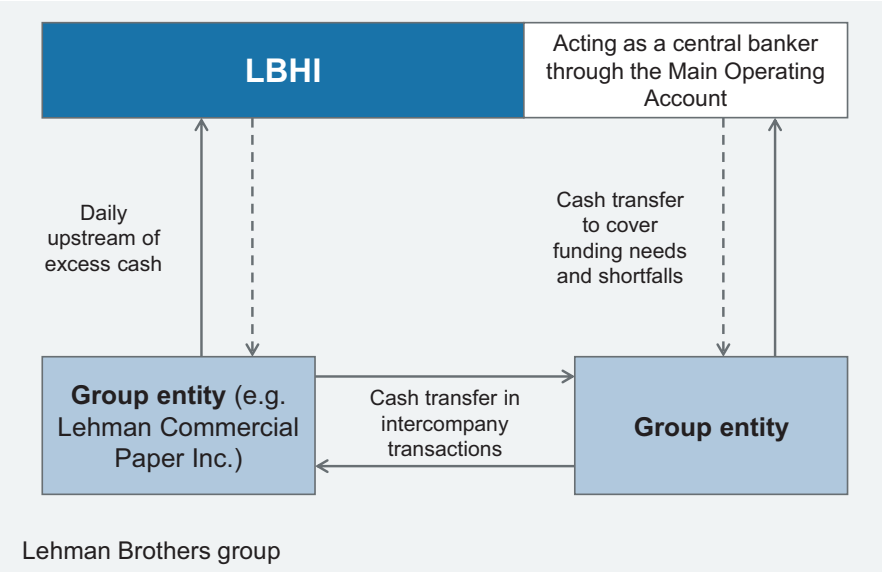

Figure 1. Lehman Brothers cash management system[17]

As a consequence, when LBHI filed for bankruptcy, a large amount of the group funds became part of the US proceedings, and therefore – as was generally held – unavailable for supporting Lehman's subsidiaries on a going concern basis.[18] On the same day as LBHI filed a Chapter 11 petition, LBIE was placed into administration in the UK, citing the limitations on the transfer and receipt of payments from LBHI.

Alongside the integrated cash management system, Lehman Brothers' intra-group financing featured an elaborate system of intercompany obligations, cross-collateralisation and intra-group guarantees.[19] Following the bankruptcy filing, highly contentious disputes arose between the group members regarding the size and validity of intra-group claims and the enforceability of guarantee claims by group affiliates against LBHI as the principal debtor or guarantor. Some of LBHI's creditors proposed consolidating the insolvency estates of Lehman's entities, and in this way eliminating cross-guarantees, intercompany and joint and several liability claims, for the most part to the benefit of LBHI's creditors. However, this proposal was ulti-

17 This figure is based on the Valukas Report, p. 1553. Not all LBHI's subsidiaries took part in the cash management system.

18 R. Herring, The Challenge of Resolving Cross-Border Financial Institutions, Yale Journal on Regulation, Vol. 31, 2014, p. 870.

19 H.R. Miller, L.R. Fife, M. Horwitz, In re Lehman Brothers Holdings Inc. From Chaos to Consensus, Presentation from 22 June 2012, stating that USD 328 billion in claims under guarantees were filed against LBHI by affiliates and that USD 255 billion in claims under guarantees were filed against LBHI by non-affiliate third parties.

mately rejected, and corporate shields of group companies were retained. Yet the redistribution of pay-outs to specific creditors, including holders of senior unsecured claims and general unsecured claims against LBHI, was agreed upon, based on an implied 20% risk of substantive consolidation.[20] The resolution of intra-group claims was facilitated through separate settlement agreements, reached between insolvency practitioners (IPs) appointed in different proceedings,[21] as well as the bankruptcy protocol. The latter set out a coherent and orderly process for the treatment of inter-company claims – a part of the protocol, referred to as "the heart of the Protocol."[22]

1.1.2 Nortel Networks

Nortel Networks group (Nortel) was another multinational giant with a long history that ended in the 21st century. Nortel was founded in 1895 in Montreal (Canada), as the Northern Electric and Manufacturing Company. The major stake in it belonged to the Bell Telephone Company of Canada (Bell Canada), one of Canada's most prominent telecommunications enterprises. It manufactured phones, telephone switchboards, gramophones and other equipment. In 1914, it merged with Imperial Wire and Cable Company to become the Northern Electric Company (Northern Electric). In this company, 44% of share capital was owned by Western Electric, a subsidiary of the American Telephone and Telegraph Company (AT&T), and the remainder belonged to Bell Canada. Until the 1950s, Northern Electric primarily relied on the designs and licenses from Western Electric.

---

20 *In re Lehman Brothers Holdings Inc., et al.*, Order confirming modified third amended joint Chapter 11 plan of Lehman Brothers Holdings Inc. and its affiliated debtors, Chapter 11 Case No. 08-13555 (JMP) (Bankr. S.D.N.Y. 2011), explaining that litigation regarding substantive consolidation "would require vast amounts of discovery and investigation into the operations of Lehman prior to the Commencement Date, would be extraordinarily complex and costly for all parties involved, and would significantly delay Distributions to all Creditors."

21 F. Verhoeven, Lehman Brothers Treasury, in M. Haentjens and B. Wessels (eds), Research Handbook on Cross-Border Bank Resolution, Edward Elgar Publishing, 2019, p. 354. *Re LB Holdings Intermediate 2 Ltd* [2017] EWHC 2032 (Ch); *In re Lehman Brothers Inc.*, Case No. 08-01420 (JMP) SIPA (Bankr. S.D.N.Y. 2013), Order approving Settlement Agreement among the Trustee, Lehman Brothers International (Europe) and the LBIE administrators.

22 Debtor's Motion Pursuant to Section 105 and 363 of the Bankruptcy Code for Approval of a Cross-Border Insolvency Protocol, *In re Lehman Brothers Holdings Inc.*, No. 08-13555 (Bankr. S.D.N.Y. 2009), at 23. Negotiations over the protocol resulted in the Global Close Balance Sheet, prepared between November 2008 and January 2009. This Global Close Balance Sheet played an important role, because it "represented the last consolidated set of books and records of the Lehman Group prior to insolvency." A. Lehavi, Property Law in a Globalized World, CUP, 2019, p. 269. The Cross-Border Insolvency Protocol for the Lehman Brothers Group of Companies <https://drive.google.com/file/d/1m1LNsoOjRXeZ7k3opnFCIxBjoOI7aBMl/view> (accessed 21 July 2023).

As a consequence of an antitrust suit in the USA, AT&T had to sell its stake in Northern Electric to Bell Canada in 1956. Having lost its access to the AT&T's resources, Northern Electric began the development of its own technologies and products, including electronic switching systems. In 1973 Northern Electric went public, with Bell Canada retaining a 90.1% stake. The 1970s and 1980s were the years of rapid growth and expansion to foreign markets, such as the USA, Europe and the Caribbean.

In 1998, the company changed its name to Nortel Networks in order to stress its shift from telecommunications to data and multimedia networking. By the year 2000, Nortel had reached its peak, representing over one third of the total value of the S&P/TSX index, employing more than 90,000 people globally, and ranking among the most valuable companies worldwide.[23] As the 2000s progressed, Nortel faced significant financial challenges, partly stemming from an aggressive acquisition strategy, high-cost structure, lack of financial discipline, questionable product-related decisions, and operational changes impairing innovation. Moreover, the post-dot-com bubble burst era brought heightened market competitiveness, further complicating Nortel's position.[24] Nortel laid off many employees, downsized its research projects and over time lost track of the evolving business and technological environment. This led to a gradual erosion of trust among its customers, who became increasingly doubtful about Nortel's long-term survival and its ability to keep R&D and maintenance promises ("black cloud"). The global recession in 2008 exacerbated the challenges faced by the once-leading telecommunications company, contributing to its downfall.

On 14 January 2009, Nortel Networks Inc. and 14 of its subsidiaries filed Chapter 11 petitions in the United States Bankruptcy Court for the District of Delaware (jointly administered). On the same day, the ultimate corporate parent of these companies, Nortel Networks Corporation, along with its own parent company Nortel Networks Limited and several affiliates, filed an application with the Ontario Superior Court of Justice under the Companies' Creditors Arrangement Act (CCAA). Simultaneously, the High Court of Justice in London placed all companies of the Nortel group, established in the EU, into administration. In May 2009, the Commercial Court of Versailles (France) opened secondary proceedings in respect of one of them,

23 For study of the causes of Nortel's failure, see An Overview of the Demise of Nortel Networks and Key Lessons Learned: Systemic effects in environment, resilience and black-cloud formation, Report by the University of Ottawa (Canada), 2014 <https://sites.telfer.uottawa.ca/nortelstudy/files/2014/02/nortel-summary-report-and-executive-summary.pdf> (accessed 21 July 2023).

24 Ibid., pp. 3-4. See also Nortel Networks Corporation Annual Report 2001 <https://bib.kuleuven.be/files/ebib/jaarverslagen/NortelNetworks_2001.pdf> (accessed 21 July 2023), reporting a net loss of USD 27.3 billion in 2001 and workforce reduction from appr. 94,500 employees at the beginning of 2001 to appr. 52,600 employees by the end of 2001.

Nortel Networks S.A.[25] Pointing out the "gargantuan bankruptcy cases" of Nortel Networks, Judge Kevin Gross of the US Bankruptcy Court for the District of Delaware wrote:

> The how and why for the downfall are the subject of numerous books and articles and the Court will not gratuitously add its views which are not necessary to the work at hand. It is sufficient to note that even a writer of fiction would not dare to compose the story of the death of this multi-national enterprise and the harm it inflicted on tens of thousands of employees and creditors.[26]

Just like Lehman Brothers, Nortel Networks was a truly multinational enterprise with a large network of branches and subsidiaries spread across the globe. It relied on operating synergies and was managed "on divisional lines that generally ignored geographical boundaries and corporate structures."[27] Judge Newbould of the Ontario Superior Court of Justice described the business structure of Nortel Networks as follows:

> Nortel (a) had fully integrated and interdependent operations; (b) had intercompany guarantees for its primary indebtedness; (c) operated a consolidated treasury system in which generated cash was used throughout the Nortel Group as required; (d) disseminated consolidated financial information throughout its entire history, save for the year before its bankruptcy; and (e) created IP [intellectual property] through integrated R&D activates that were global in scope.[28]

Nortel's business was highly integrated. This integration was in part determined by the nature of its main assets – patents and other intellectual property, developed in labs around the world and shared throughout the group. This is why upon the onset of insolvency, the entity-by-entity allocation of ownership rights over the intangible assets among enterprise group members was difficult (if not impossible), and in any case, it would have likely resulted in significant costs and protracted court battles.

The problem was solved by an agreement of all major parties to sell the key assets on a global basis, largely ignoring corporate and geographical boundaries. According to this agreement,[29] the sales proceeds were to be deposited into an escrow account. The distribution of these funds would be

---

25 On the interaction between the UK main and French secondary proceedings, see R. Dammann, Lessons to be learned from the Nortel case, Eurofenix, No. 82, Winter 2020/21, pp. 34-35.

26 *In re Nortel Networks, Inc.*, 532 B.R. 494, 499 (Bankr. D.Del. 2015).

27 J.L. Westbrook, Transparency in Corporate Groups, Brooklyn Journal of Corporate, Financial & Commercial Law, Vol. 13, 2018, p. 37.

28 *Nortel Networks Corporation (Re)*, 2015 ONSC 2987, 12 May 2015.

29 The Nortel Interim Funding and Settlement Agreement (Execution version) <https://drive.google.com/file/d/1vnjSuD9xEQJSPECv_3TzxYJ99-YpXPoY/view?usp=sharing> (accessed 21 July 2023).

carried out either through the agreement of all selling debtors on a method of allocation or, in case of disagreement, upon the "determination of any dispute relating thereto by the relevant dispute resolver."[30] Because of this "unified" approach to the realisation of the group's assets, Nortel could sell its business lines for approximately USD 3.285 billion and the intellectual property for USD 4.5 billion, totalling in USD 7.3 billion being placed in the so-called "lockbox" with JP Morgan in New York.[31]

However, the sale of the group's assets was only a part of the story, perhaps the easiest part. Once the money was received in the escrow account, naturally, the distributional issues arose. These turned out to be very complex and divisive. The complexity was attributed to the legal separateness of group members, underpinning the separateness of insolvency estates of such members, as well as their liabilities. It was further complicated by the fact that some creditors – notably bondholders and pensioners ("double claimants") – simultaneously asserted their claims against several companies within the Nortel group.[32] After the failed attempts to resolve the deadlock through mediation,[33] the disputes concerning the allocation of proceeds ended up in courts of several jurisdictions. These disputes lasted for nearly a decade, translating in substantial expenses and creating frustration among creditors.[34]

The courts in the USA and Canada recognised that the Nortel enterprise as a whole developed assets in common, and that it was not possible or fair to give any of the group entities certain and calculable claims to the proceeds from the liquidation of the group's assets. Instead, a pro rata allocation method was adopted. According to this method, referred to by the US court as an "extraordinary result", each debtor was to receive a

30 *Nortel Networks Corporation (Re)*, 2015 ONSC 2987, 12 May 2015.

31 Ibid. See L.L. Peacock, A Tale of Two Courts: The Novel Cross-Border Bankruptcy Trial, American Bankruptcy Institute Law Review, Vol. 23, 2015, pp. 543-570.

32 J.L. Westbrook, Corporate Formalism in a Global Economy, in J.P. Sarra and B. Romaine (eds), Annual Review of Insolvency Law, Toronto: Carswell, 2015, p. 311.

33 J.A.E. Pottow, Cross-border corporate insolvency in the era of soft(ish) law, in B.E. Adler (ed), Research Handbook on Corporate Bankruptcy Law, Edward Elgar Publishing, 2020, p. 347, noting a spectacular failure of the mediation attempts.

34 See E.J. Janger and S. Madaus, Value Tracing and Priority in Cross-Border Group Bankruptcies: Solving the Nortel Problem from the Bottom Up, University of Miami International and Comparative Law Review, Vol. 27, 2020, pp. 334-357, observing that the Nortel's story represents a remarkable paradox in recent cross-border restructuring practice, standing as both the biggest success and the biggest failure. This is due to the fact that despite securing the high purchase price for the group's assets, the fight over the allocation of proceeds consumed a large chunk of the asset value, estimated at a staggering USD 2.6 billion. On Nortel's insolvency, see J.A.E. Pottow, Two Cheers for Universalism: Nortel's Nifty Novelty, in J.P. Sarra and B. Romaine (eds), Annual Review of Insolvency Law, Toronto: Carswell, 2015, pp. 333-367.

percentage of the lockbox funds that corresponded to the percentage of the total allowed claims against that specific debtor relative to the total allowed claims against all group debtors. This method was chosen over alternatives, such as the "revenue" and "contribution" approach, or the ownership allocation, suggested by the parties seeking more beneficial treatment.[35] The chosen method upheld the separateness of the group companies' insolvency estates, from which distributions were to be made. It also maintained intercompany claims for the purposes of determining the amount of claims against the relevant debtors.

As to intra-group guarantees, the courts in the USA and Canada came to the conclusion that there was insufficient evidence that the guaranteed creditors, such as bondholders, relied on corporate separateness of various companies comprising the group. They also noted that the market did not differentiate the bonds that carried a guarantee and those that did not. At least the opposite was not reflected in the terms of bond documentation. As a result, it was decided that a claim that can be filed against more than one debtor, inter alia, due to a cross-guarantee, should only be calculated and recognised once. This is an unusual approach, as the main point of a guarantee, as explained in Chapter 6, is that it effectively "multiplies" a claim by allowing simultaneous filings against the principal debtor and a guarantor. In Nortel, for the allocation purposes, guaranteed claims were to be included only against the principal obligor (i.e. issuer). It was stressed that any other approach would give guaranteed creditors access to the lockbox funds, representing assets of 38 group entities, some of which did not provide guarantees.[36] That being said, the guaranteed creditors could still claim for any shortfall from an entity that has provided a guarantee in order to participate in the distribution with other creditors.[37]

1.1.3 Oi Brazil

Oi group (Oi Brazil), formerly known as Telemar, is a large fixed and mobile telephone operator in Brazil and one of the largest telecommunications enterprises in Latin America. Founded in 1998 as Tele Norte Leste during Brazil's telecommunications sector privatization, the company was rebranded as Oi in 2007. By 2015, Oi employed 140,000 direct and indirect employees in Brazil, operated 651,000 public telephones, over one million

35 *In re Nortel Networks, Inc.*, 532 B.R. 494 (Bankr. D. Del. 2015), comparing the allocation dispute between the US, Canadian and EMEA parties to "three people trying to reach the top of a mountain by pulling the others down. In other words, no one gets to the top."

36 *Nortel Networks Corporation (Re)*, 2015 ONSC 2987, 12 May 2015.

37 D. Miller and M. Shakra, *Nortel*: The Long and Winding Road, in J.P. Sarra and B. Romaine (eds), Annual Review of Insolvency Law, Toronto: Carswell, 2015, p. 299.

public Wi-Fi hotspots and 330,000 kilometres of fibre optic cables.[38] Its financial problems stemmed from debt accrued in mergers and acquisitions, mounting competition in mobile and data sectors, declining demand for fix-line services (main operational focus of Oi Brazil), and the heavy capital expenditures required for the government-mandated expansion of its fixed-line network in rural areas experiencing negative growth.[39]

Affected by Brazil's economic downturn that commenced in 2014 and the ensuing political uncertainty, Oi Brazil was facing unsustainable debt levels, predominantly arising from New York and English law governed bonds. Some of them were issued by the Dutch financing subsidiaries Portugal Telecom International Finance B.V. (PTIF) and Oi Brasil Holdings Coöperatief U.A. (Coop) and guaranteed by the group's parent, Oi S.A. The funds received by PTIF and Coop from the sale of notes to investors were on-lent to other group entities to finance their operational activities. Hence, the repayment of the notes fully depended on the financial conditions of Oi S.A and its operating subsidiaries. This type of arrangement is common among large multinational groups.[40] The use of special purpose financing companies, intercompany guarantees and intra-group transfers facilitates access to foreign capital markets, reduces the cost of capital for the entire group and enables efficient allocation of resources within it.

Following the unsuccessful attempts to reach an out-of-court debt restructuring agreement with bondholders, Oi S.A. and several of its subsidiaries, including PTIF and Coop, filed for a jointly administered reorganisation proceeding (*recuperação judicial*) in Brazil on June 20, 2016. The Brazilian court accepted jurisdiction over PTIF and Coop. The centralised restructuring of the multinational enterprise group was seen by the parent company as the preferred solution over an alternative approach involving the sale of assets on an entity-by-entity basis.

In Brazil, corporate separateness has historically been upheld. However, since 2014, courts have increasingly confirmed restructuring plans that involve substantive consolidation of assets and liabilities of separate

38 *In re Oi Brasil Holdings Coöperatief U.A.*, 578 B.R. 169 (Bankr. S.D.N.Y. 2017).

39 Ibid. See also J. Leahy and S. Pearson, Oi bankruptcy spotlights Brazilian debt problems, Financial Times, 21 June 2016.

40 INSOL International Special Report, Restructuring Cross-border Groups: Key Considerations Around Foreign Tax and Finance-driven SPVs, June 2020.

companies.[41] In the Oi Brazil case, the initial proposal for a reorganisation plan was also based on substantive consolidation. Nevertheless, the Brazilian court decided that the issue of substantive consolidation should be determined by creditors of each entity. For the voting purposes, the court determined that guarantees on the bonds should not be counted.[42] This is despite the fact that substantive consolidation may and usually does have a direct effect on distributions to guaranteed creditors. Without it, such creditors have two paths for recovery: (i) against the principal debtor (issuer) which itself has a claim against the guarantor based on an intra-group loan, and (ii) against the guarantor (ultimate borrower) that owes money to the internal lender (issuer). This dual recovery strategy is sometimes referred to as the "double dip" because it permits the creditor to make more than one claim in relation to the same debt.

In parallel to the centralised restructuring process in Brazil, separate bankruptcy proceedings against PTIF and Coop were initiated in the Netherlands. After months of litigation, the Dutch Supreme Court (*Hoge Raad* or HR) upheld the jurisdiction of Dutch courts over these entities. It almost automatically tied the question of international insolvency jurisdiction to the fact that Coop and PTIF were separate legal persons incorporated under Dutch company law.[43] As part of the Dutch bankruptcy proceedings, in May 2017, the trustee of Coop initiated an avoidance action in the Dutch court, challenging certain intra-group transfers and seeking the repayment in relation to several loans made by Coop to other group entities.

When bondholders realised that there would be no compensation offered on the intercompany claims, some of them attempted to interfere in the centralised restructuring process or gain leverage via recognition of the Dutch bankruptcy proceedings as the foreign main proceedings in the USA. These attempts were unsuccessful. The US court had previously recognised the Brazilian insolvency proceeding as the foreign main insolvency proceeding

41 S.C. Neder Cerezetti, Reorganization of Corporate Groups in Brazil: Substantive Consolidation and the Limited Liability Tale, International Insolvency Review, Vol. 30, 2021, pp. 169-190, noting the wide and unsubstantiated use of substantive consolidation in Brazil and the weakening role of limited liability and asset partitioning. See also *In re Rede Energia S.A.*, 515 B.R. 69, 100 (Bankr. S.D.N.Y., 2014), referring to the Brazilian Bankruptcy Court, which found that substantive consolidation of the Rede debtors was appropriate for plan purposes, because these debtors were "organized as a corporate group, with a common controlling company and credit inter-dependence" as a result of loans that exist between the companies in the group and cross-corporate guarantees to third parties.

42 R.J. Cooper, F.L. Cestero and J.W. Mosier, Oi S.A.: The Saga of Latin America's Largest Private Sector In-court Restructuring, Pratt's Journal of Bankruptcy Law, Vol. 14, 2018, p. 211.

43 HR 7 July 2017, ECLI:NL:HR:2017:1280, r.o. 3.1, *NJ* 2018/363; HR 7 July 2017, ECLI:NL:HR:2017:1281, r.o. 3.1, *NJ* 2018/364, m.nt. F.M.J. Verstijlen.

under Chapter 15 of the US Bankruptcy Code. Now the bondholders tried to overturn such recognition. The court characterised this behaviour as an attempt to weaponize Chapter 15 "to collaterally attack both the Brazilian RJ Proceeding and the Oi Group's proposed Brazilian RJ Plan."[44]

As the powers of the Dutch bankruptcy trustees were not recognised in Brazil, any coordination and cooperation between parallel insolvency proceedings was stalled. The trustees of Coop and PTIF were not allowed to interfere with the restructuring process in Brazil under Brazilian law, even though they may have been required to do so under Dutch law, acting in the interests of creditors, including the bondholders seeking the described "double dip" recovery.[45] The deadlock was particularly difficult to resolve, as neither the Netherlands (outside the European context) nor Brazil had comprehensive rules on international insolvencies, let alone the rules on mutual recognition of restructuring plans.[46]

The restructuring plan (RJ plan) was approved at a 14-hour creditor meeting, held on 19 and 20 December 2017, in which more than 1,000 people gathered in a former Olympic venue in Rio de Janeiro. The plan was confirmed by the Brazilian court on 8 January 2018 and became effective on 5 February 2018. According to the plan, the bondholders of Coop and PTIF were entitled to elect to receive as recovery for the claims: (i) a package of securities and common shares of Oi, or (ii) the right to receive the full amount of their claims with a 20-year principal grace period.[47] Following the approval of the RJ plan in Brazil, the composition plan was proposed in the Dutch bankruptcy proceedings. This plan effectively mirrored the terms of the Brazilian restructuring plan and was consistent with it in all

44 *In re Oi Brasil Holdings Coöperatief U.A.*, 578 B.R. 169, 242 (Bankr. S.D.N.Y. 2017); *In re Oi Brasil Holdings Coöperatief U.A.*, 582 B.R. 358 (Bankr. S.D.N.Y. 2018), refusing to reconsider the recognition decision and denying the petition for recognition of the Dutch bankruptcy proceedings. See, however, P.J.M. Declercq, The actions of a distressed investor in the restructuring of Brazilian Telecom Group Oi SA assessed - villain or essential contributor to the development of law & practice in cross-border restructurings/insolvencies of groups? INSOL World, Second Quarter 2018, pp. 12-14.

45 J.H. Overduin, J.M.W. Pool, De curator in de spagaat: tussen Nederlandse taakuitoefening en het belang van een internationale herstructurering. Interview met curatoren Marcel Groenewegen (PTIF) en Jasper Berkenbosch (Oi Coop) over de voorlopige surseances en faillissementen van de financieringsmaatschappijen van Oi Telecom, Tijdschrift voor Insolventierecht, 2020/9, p. 58-67, describing the complexities of the Oi restructuring process, based on the interviews with the Dutch trustees of Coop and PTIF.

46 In December 2020, Brazil adopted the law implementing the UNCITRAL Model Law on Cross-Border Insolvency. This law is in force as of 23 January 2021.

47 The summary of the key terms of the RJ Plan <https://cms.law/en/content/download/342269> (accessed 21 July 2023).

material aspects.[48] Although the amount of distribution was not entirely clear, the composition plan received support from the creditors of PTIF and Coop, who agreed that their claims against various Oi group entities would receive equal treatment. The Dutch court approved this plan on 11 June 2018.[49] This marked the end of the long rivalry between parallel proceedings and provided a much-needed resolution to the complex insolvency case. Chapter 15 cases were closed in 2023.

1.1.4 Common features of group insolvencies

Leo Tolstoy's novel Anna Karenina (1877) begins with a saying: "All happy families are alike; each unhappy family is unhappy in its own way" (in Russian: *Все счастливые семьи похожи друг на друга, каждая несчастливая семья несчастлива по-своему*). In the same way, the three insolvency stories described above are different from each other. This concerns their individual circumstances, causes of financial distress of once booming businesses, behaviour of parties and the outcomes reached. Two of the three companies no longer exist. However, despite these differences, there are commonalities or similar features shared among all three cases, though varying in extent or degree.

- The first feature relates to the fact that multinational enterprises are often organised as multi-layered structures, consisting of many levels of subsidiaries performing different functions and located in different countries. This multi-layered corporate structure can result in multiple insolvency proceedings initiated against group members in different jurisdictions and subject to different laws. The coordination of these proceedings with the aim of value preservation – either through a global sale of assets, as in the case of Nortel Networks, or via a comprehensive group-wide restructuring plan, as in Oi Brazil – is problematic and costly.
- The second feature concerns the integrated nature of enterprise groups, as mentioned earlier. This group integration materialises in the manner in which the corporate group is managed and in the degree of operational and financial interconnectedness. It may also translate in the division of responsibilities within the group. For example, specific companies within the group may be tasked with raising funds from investors, as seen in the case of special purpose financing vehicles used

48 See Advice regarding composition plan ex art. 140 DBA by Mr. J.R. Berkenbosch, 26 April 2018 <https://cms.law/nl/content/download/344103/8925087/version/1/file/Oi_Coop_Advice_Bankruptcy_Trustee_Article_140_DBA_26_April_2018_English.pdf> (accessed 21 July 2023).

49 Rb. Amsterdam 11 June 2018, ECLI:NL:RBAMS:2018:5047 (*PTIF*); Rb. Amsterdam 11 June 2018, ECLI:NL:RBAMS:2018:5048 (*Oi Coop*), *JOR* 2018/259, m.nt. W.J.M. van Andel.

by Lehman Brothers and the Oi group. Others could function as a group bank, collecting and re-distributing liquidity to different group entities. In highly integrated groups, the allocation of assets or liabilities to a particular group entity can be challenging due to the intermingling of assets and liabilities or the collective effort to generate enterprise value, as witnessed in the case of Nortel Networks.

- The third feature refers to the prevalence of group-specific financial arrangements. In many enterprise groups, financing is coordinated and organised at a group level with the involvement of different group entities. It is common in practice for legally separate entities to enter into transactions to reallocate funds within the group (e.g. intra-group loans, centralised cash management), or to support each other in securing external financing (e.g. intercompany guarantees, co-debtorship, provision of collateral). These transactions seek to optimise liquidity allocation inside the group, maximise economic efficiency by minimizing tax exposure, provide access to foreign capital markets and ultimately secure better lending terms. While the group is solvent and there is no default on obligations, such financial arrangements usually do not create any problems. Yet in situations of financial distress and insolvency, they can give rise to prolonged disputes and complicate the efficient administration and resolution of group insolvencies. Typical disputes concern the validity of pre-insolvency intra-group transfers, the calculation, attribution and enforcement of intercompany claims, access to intra-group financing, and the potential threat of substantive consolidation. Thus, both the presence of intra-group liability arrangements and the challenges they present in insolvency proceedings are pervasive.

These shared similarities, characterising the operation and financing of groups of companies, together with the commonality of challenges and problems arising in group insolvencies, create a solid ground for this study. The cases of Lehman Brothers, Nortel Networks and Oi Brazil are eye-opening and representative of both the complexities of group insolvencies, unravelling power struggles between different creditors (or even countries) and the desirability or necessity of group-sensitive legal responses or solutions. Throughout this book, these cases will serve as valuable reference points.

1.2 Main Question

This book explores financial arrangements between group entities, their creditors, and other stakeholders in the context of financial distress and insolvency. The latter create tension and conflicts between debtors and their creditors, as well as between different groups of creditors, and debtors. Traditionally, the role of insolvency law was narrowly perceived as a mecha-

nism to resolve these conflicts through a regulated, orderly, and collective process.[50] According to the well-known and influential theory of corporate insolvency – Jackson's creditors' bargain theory – insolvency law primarily serves to establish a collective process that prevents creditors from engaging in a destructive "grab race", because it could lead to the loss of going concern value and piecemeal liquidation of assets.[51] The creditors' bargain theory looks at the collective realisation of assets and distribution questions as applied to a single debtor and not necessarily to a group of separate but connected debtors.

For historical, economic, social and political reasons, the handling of financial distress and the application of insolvency law have been carried out on a single-jurisdiction and a single-entity level, frequently overlooking the wider corporate group context.[52] In other words, the rules of insolvency but also of company law are founded on a single-entity (i.e. single-debtor) vision.[53] We will refer to this vision as "entity bias". Often, it fails to reflect the complex realities of modern economies, where enterprise groups have emerged as the predominant form of large-sized enterprises in Europe and

50 In the UK, the term "bankruptcy" refers to the process concerning natural persons, while "insolvency" applies in relation to corporations. In the USA, the term "insolvency" describes the state of the debtor being insolvent, whereas "bankruptcy" relates to a statutory process of dealing with a debtor under the US Bankruptcy Code, whether the debtor is a legal or natural person. In the Netherlands, the term "bankruptcy" is commonly used when referring to the "traditional" bankruptcy procedure (*faillissement*) of the Dutch Bankruptcy Act, while "insolvency" tends to reflect the financial state of the debtor. In the EU and UNCITRAL instruments, the term "insolvency" is predominant, as referring to both the state of financial distress and the procedure (i.e. insolvency proceedings). For an overview of the historical roots of the modern terms and a brief history of bankruptcy, see H. Rajak, The Culture of Bankruptcy, in P.J. Omar (ed), International insolvency law. Themes and perspectives, Routledge, London and New York, 2008, pp. 3-25. In order to avoid confusion, in principle, in this book we will use both terms interchangeably, while trying to accommodate national preferences when discussing national law.

51 T.H. Jackson, Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain, The Yale Law Journal, Vol. 91, 1982, pp. 857-907; T.H. Jackson, Translating Assets and Liabilities to the Bankruptcy Forum, The Journal of Legal Studies, Vol. 14, 1985, pp. 73-114; T.H. Jackson, The Logic and Limits of Bankruptcy Law, Harvard University Press, 1986.

52 K. van Zwieten, Goode on Principles of Corporate Insolvency Law, 5th edn, Sweet & Maxwell, 2018, para. 1-29, noting that the "subject of insolvency proceedings has always been, and continues to be, the particular corporate entity that has become insolvent."

53 It appears that greater progress in recognising and regulating enterprise groups has been achieved in the areas of tax law, competition law, anticorruption law and human rights. See K.E. Sørensen, The Legal Position of Parent Companies: A Top-Down Focus on Group Governance, EBOR, Vol. 22, 2021, pp. 433-474.

beyond.[54] This is also true for many small and medium-sized firms.[55] Vividly described by Westbrook as "a legal armada of limited liability vehicles, each of which may have billions of dollars in assets or nearly none"[56], corporate groups exhibit intricate and interconnected structures. The insolvencies of corporate giants like Lehman Brothers, Nortel Networks, Oi Brazil, and more recently, of Hertz, LATAM Airlines and FTX, with debtor entities scattered all over the world, attest that group entities not only live together, but also die or recover together.[57]

Currently, there seems to be a clear shift in the treatment of enterprise groups, marked by the emergence of new rules and soft-law instruments, which target insolvency of corporate groups. The adoption of the Bank Recovery and Resolution Directive in 2014 (BRRD),[58] the European Insolvency Regulation in 2015 (EIR Recast)[59], the UNCITRAL Legislative Guide on Insolvency Law, Part three (2010),[60] and, more recently, the UNCITRAL Model Law on Enterprise Group Insolvency (MLEGI, 2019)[61] signify a new stage in the development of modern insolvency law. These instruments

54 Report of the Reflection Group on the Future of EU Company Law, 5 April 2011, p. 59, highlighting that "business activity is typically organised and conducted through a network of individual subsidiaries located in several States inside and outside Europe." L.A. Dau, R. Morck and B.Y. Yeung, Business groups and the study of international business: A Coasean synthesis and extension, Journal of International Business Studies, Vol. 52, 2021, p. 161, noting that "[b]usiness groups are not only prevalent across much of the globe but, in many countries and regions, are the primary form of business organization." K.J. Hopt, Groups of companies: A Comparative Study of the Economics, Law, and Regulation of Corporate Groups, in J.N. Gordon, W-G. Ringe (eds), The Oxford Handbook of Corporate Law and Governance, OUP, 2018, p. 603, observing that "[g]roups of companies rather than single independent companies are the modern reality of the corporation."

55 Commission Assessment accompanying Proposal for a Directive on preventive restructuring frameworks, SWD(2016) 357 final, 22 November 2016, p. 35, stating that "[t]here are more than one million SMEs in Europe which have subsidiaries or joint ventures abroad."

56 J.L. Westbrook, Transparency in Corporate Groups, Brooklyn Journal of Corporate, Financial & Commercial Law, Vol. 13, 2018, p. 41, arguing on p. 34 that "the very structure of a modem corporate group can make it the engine of injustice and fraud."

57 P. Blumberg, The Transformation of Modern Corporation Law: The Law of Corporate Groups, Connecticut Law Review, Vol. 37, 2005, p. 605, pointing out the emergence of multinational corporations as the dominant institutions in the world's economy and arguing that "traditional corporation law presupposing as its subject the individual corporation and looking upon it as the basis legal unit entity no longer adequately serves all the needs of modern jurisprudence."

58 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.

59 Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings.

60 UNCITRAL Legislative Guide on Insolvency Law (UNCITRAL Legislative Guide), Part three: Treatment of enterprise groups in insolvency, 2010.

61 UNCITRAL Model Law on Enterprise Group Insolvency.

pursue the objective of accommodating the economic reality or realities of corporate groups and removing the obstacles to resolution of their financial distress. The same trend is observed at the national level, with jurisdictions, like Germany, enacting laws tackling insolvencies within enterprise groups and permitting procedural consolidation – concentrating proceedings of group entities in the same forum or court.[62]

This book explores this recent development from a specific angle. Acknowledging complexity and multi-facetedness of group structures and relationships, it focuses on *intra-group financial arrangements*, their influence on and treatment in insolvency and restructuring of corporate groups. Some of the most common intra-group financial arrangements, examined in this book, include cross-guarantees and intra-group loans. The book also scrutinises contractual clauses, which have an effect of implicating several group entities, namely intercompany ipso facto and cross-default clauses. On the one hand, these arrangements can have a positive effect in the form of reduced agency costs and risk mitigation – ex ante resulting in a lower cost of debt and greater liquidity. On the other hand, intra-group financial arrangements promote group inter-dependence and could magnify the risk of contagion and opportunistic behaviour within the group. As exemplified by the cases of Lehman Brothers, Nortel Networks and Oi Brazil, intra-group financial arrangements are a divisive and conflict-ridden area of insolvency law and practice. At least one reason for this is that they often drive stakeholders further apart rather than align their interests. Some creditors may have a "priority" arising from a right of recourse against several group entities at the same time (due to a cross-guarantee or co-debtorship), while others do not. This indirect priority amplifies coordination and collective action problems, elevating them to the group level.

Group insolvencies and intra-group financing is also a field where the principles of insolvency law and other areas of law conflict.[63] Think of cross-guarantees and ipso facto clauses. They arise from freedom of contract and serve to create certainty for the creditor and minimise risks from a counterparty's default. However, their enforcement may promote group exposure, have detrimental impact on the going concern value and misalign

62 German Insolvency Code (*Insolvenzordnung* or InsO), § 3a and § 56b, aiming at establishing a common forum and a common administrator for the group. See also § 269d-269i (*Koordinationsverfahren*), introducing coordination proceedings.

63 For example, the principle of freedom of contract may collide with the principle of preserving and maximising the insolvency estate value. This is evident where contractual provisions allow the withdrawal of future performance or automatically lead to the amendment or termination of a contract upon a certain insolvency-related event (ipso facto clauses). Enforcement of such provisions may cause disruption of operating activities and early liquidation, thereby likely undermining the debtor's going concern value and restructuring prospects. Ipso facto clauses are addressed in Chapter 9 of this book.

the interests of creditors. This is why, in some cases, contractual freedom is abrogated or curbed to facilitate group restructuring in furtherance of the principle of estate value preservation and maximisation. Thus, on a meta-level, this book is about conflicts between various parties and legal principles, and about their resolution.

Against this background, the book aims to answer the question: *how should insolvency law be designed to best balance conflicting legal principles in the context of intra-group financing?* To answer this question, some interim steps should be taken. We should:

- introduce groups of companies and explain different organisational and financial arrangements characterising them;
- identify legal principles at stake (or in conflict) in the context of intra-group financing and group insolvency;
- examine how legislators and courts in different jurisdictions decide cases where the relevant legal principles are not aligned; and
- dissect and analyse the factors that influence a resolution of conflicts between legal principles.

This inquiry is prima facie theoretical. Yet it has major practical consequences.

1.3 Scope and Aims of This Book

Before examining the challenges posed by intra-group financing and group insolvency, some general observations and clarifications related to the scope of this study, its structure and the terms used in it are necessary.

First, the book is a study of insolvency law. This law is understood broadly to include various proceedings which seek to resolve corporate financial distress. These proceedings encompass "traditional" or "classical" fully collective proceedings, addressing the problem of a general default and aimed at joint satisfaction of all debtor's creditors.[64] It also includes proceedings that are not premised on or do not require full collectivity (e.g. Dutch WHOA schemes, English schemes of arrangement), and that may be available in the absence of insolvency. However, the focus of this book is limited to the use of these proceedings to resolve financial problems of

64 The collectivity requirement has been described as the key defining characteristic of insolvency proceedings. See H. Eidenmüller, What is an insolvency proceeding? ECGI Law Working Paper No. 335/2016, December 2016 <https://ecgi.global/working-paper/what-insolvency-proceeding> (accessed 15 July 2023), arguing that in a cross-border context, only "fully collective" proceedings should be characterised as insolvency proceedings. For a different view, see G. Ray Warner, Comparative collectivity: European Union and United States approaches, International Insolvency Review, Vol. 32, 2023, pp. 156-175, referring to the collectivity requirement as "unworkable", and noting the shift towards the fairness requirement in recognition cases.

commercial enterprises. This includes situations where a company is insolvent or imminently insolvent, and where it is technically solvent but faces a reasonable likelihood of insolvency. Therefore, this book does not address solvent procedures (e.g. the use of English schemes for takeover purposes) and procedures aimed at a discharge of debt for natural persons (e.g. English individual voluntary arrangements). The law of personal insolvency pursues specific policy goals and principles (e.g. fresh start), distinct from those of corporate insolvencies.[65]

We recognise that the appearance of new procedures and the possibility to use the same ones by both solvent and insolvent companies, collectively or selectively, have somewhat blurred the boundaries of what is called "insolvency law". There are divergent views on what insolvency law is and whether restructuring law is a part of insolvency law, or whether it is a separate area of law with its own unique set of doctrines and principles.[66] This book acknowledges important differences between the distinct types of procedures. That said, the broad approach advocated in this book is justified, given that the resolution of financial distress within enterprise groups and the accompanying legal tools dealing with intra-group financing can be implemented via insolvency and restructuring proceedings,[67] whether

65 See I. Ramsay, Personal Insolvency in the 21st Century: A Comparative Analysis of the US and Europe, Hart Publishing, 2017.

66 S. Madaus, Leaving the Shadows of US Bankruptcy Law: A Proposal to Divide the Realms of Insolvency and Restructuring Law, EBOR, Vol. 19, 2018, pp. 615-647, proposing to distinguish insolvency law – addressing the present common pool problem via a collective liquidation process, and restructuring law – aiming at facilitating the conclusion of a restructuring agreement and dealing with entitlements to future revenue streams. Also, S. Paterson, Rethinking the Role of the Law of Corporate Distress in the Twenty-First Century, LSE Law, Society and Economy Working Papers 27/2014, 2014, p. 3, distinguishing insolvency law that addresses "the situation in which some or all of the existing stakeholders who finance the firm no longer wish to support it and new financiers cannot be found" and restructuring law where "the majority of the existing financial stakeholders wish to continue to remain invested in the firm but must agree a new bargain." In other words, whereas insolvency law imposes a collective process to maximise capital that can be redeployed in the economy, restructuring law solves the deadlock created by the hold-out position of an individual creditor who does not agree to a new bargain.

67 In literature, there are no universally recognised boundaries of what constitutes "restructuring", its content and aims. Restructuring can be understood in the narrow sense to include only procedures where the business remains within the debtor's corporate shell. See B. Wessels, S. Madaus, Rescue of Business in Insolvency Law. Instrument of the ELI, 2017, p. 71 <https://ssrn.com/abstract=3032309> (accessed 15 July 2023). It can also be viewed more broadly, as incorporating procedures seeking preservation of the business as an organisational entity rather than the debtor's corporate shell, and therefore including a transfer of the business from the debtor to another legal entity via a going concern sale. See R. Bork, Corporate Insolvency Law. A Comparative Textbook, Intersentia, 2020, pp. 4, 165-166. Bork distinguishes "restructuring" per se, which removes debt from the business, and "asset-deal restructuring", which removes the business from its debt. This book generally adheres to the latter interpretation of restructuring as seeking either the rescue of the debtor company or at least of its business.

fully collective and insolvency-tested or not. Often, parallel proceedings are opened in different jurisdictions (e.g. US Chapter 11 and UK scheme of arrangement, Dutch WHOA and UK scheme of arrangement), some of which are fully collective, while others are not, but each represents a piece of one "group puzzle".[68] The openness of our approach reflects the versatility of ways in which financial distress within corporate groups may be tackled.

Second, this book addresses contractual and other voluntary financial arrangements. Based on an extensive literature review and conversations with practitioners and academics, the following transactions or financial arrangements have been selected in view of their prevalence in enterprise groups and importance in practice:

- group guarantees, co-debtorship and other consensual forms of shared liability;
- intra-group loans and centralised cash management; and
- intercompany ipso facto and cross-default clauses.

This selection limits the scope of our investigation in two important ways. Firstly, we do not examine non-contractual arrangements or involuntary situations that could lead to joint and several liability of several group members. For example, we will not address the liability of a parent company in tort for actions or inactions of its subsidiaries. Like personal insolvencies, corporate torts raise unique legal and moral questions that deserve a careful examination and possibly a different analytical approach.[69] Secondly, our primary concern lies in pre-insolvency transactions and the treatment of "original" creditors. Consequently, "non-original" creditors, including distressed debt investors, and claims trading more generally, fall outside the scope of our analysis. Claims trading and the position of specialized distressed investors raise distinct policy concerns, which are not necessarily specific to group scenarios.[70]

---

68 A good example illustrating the global resolution of financial distress is restructuring of Hertz. See J.A.E. Pottow, Love *Hertz*: Corporate Groups and Forum Selection, Texas International Law Journal, Vol. 56, 2021, pp. 155-180.

69 See H. Hansmann and R. Kraakman, The End of History for Corporate Law, Georgetown Law Journal, Vol. 89, 2001, p. 466, arguing that when it comes to corporate torts, the rule of limited liability "induces inefficient risk-taking and excessive levels of risky activities – inefficiencies that appear to outweigh by far any offsetting benefits, such as reduced costs of litigation or the smoother functioning of the securities markets."

70 For discussion of distressed debt trading, see L. Welling-Steffens, J.A. Ellias, S.W. van den Berg, T. Florstedt, Distressed Debt Trading – Brave New EU Legal Rules in Relation to Bold New Strategies, NACIIL 2019 report, Eleven International Publishing, 2019 <https://naciil.org/2021/08/20/reports-2019-distressed-debt-trading-brave-new-eu-legal-rules-in-relation-to-bold-new-strategies/> (accessed 15 July 2023).

Third, the research question and approach of this book necessitate a broad inquiry into and comparison between different national legal systems, and into ideas and solutions which they developed to tackle similar problems. Nevertheless, it is not the purpose of this book to propose how a given legal system (e.g. Dutch bankruptcy law) can be improved. Instead, our analysis of national laws and their application on the ground aims to provide valuable insights into legal instruments and commercial practices, as well as how national laws strike a balance between conflicting principles. These comparative insights help us discover some common threads and serve as a foundation for suggestions concerning the design of insolvency law.

The primary focus of this book is on three jurisdictions: the USA, the UK and the Netherlands. They are Western common and civil law jurisdictions – neither too similar nor too different from each other.[71] They are sufficiently comparable from economic, social and cultural perspectives, which underpin insolvency law. Markesinis and Fedtke assert that in selecting a range of legal systems for comparative research, one should choose "a system on the basis of its prima facie richness, development, relevance, and transplantability."[72] The legal regimes of the USA, the UK and the Netherlands are examples of such a system, from which inspiration may be sought, at least on the subject of this book.[73]

Bankruptcy law of the USA, and specifically Chapter 11 of the US Bankruptcy Code, influenced insolvency law reforms around the world.[74] It was used by many non-US groups of companies, seeking to benefit from its highly sophisticated and debtor-friendly provisions. In the 2000s, English schemes of arrangement[75] gradually gained popularity as a tool for group (financial) restructurings. They have been exported to numerous other (mainly common law) jurisdictions, including Australia, New Zealand, Canada, Hong Kong, Ireland, Singapore, and the Cayman Islands.[76] They

71 Siems describes this selection as one favoured by traditional comparative lawyers. M. Siems, Comparative Law, 2nd edn, CUP, 2018, p. 18.

72 B. Markesinis, J. Fedtke, Engaging with Foreign Law, Hart Publishing, 2009, p. 50, and continuing on p. 51 that a "claim that the codes, laws, and judicial decisions of all systems are of intellectual value and practical utility can only be made by those who wish to be politically correct or otherwise gain some 'favour' from such proclaimed open-mindedness."

73 This does not mean that other legal systems, not covered in this book, are less relevant or inspirational.

74 It is 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." E. Warren, J.L. Westbrook, The Success of Chapter 11: A Challenge to the Critics, Michigan Law Review, Vol. 107, 2009, p. 604.

75 Companies Act 2006, Part 26 (schemes of arrangement). The book also discusses Part 26A (restructuring plans), sometimes referred to as "super-schemes."

76 For an overview of schemes in some common law jurisdictions, see J. Payne, Schemes of Arrangement: Theory, Structure and Operations, CUP, 2014, Chapter 8.

have also served as role models or sources of inspiration for modern reforms in some European civil law jurisdictions, such as Germany and the Netherlands. The latter has positioned itself as an emerging restructuring hub, introducing a legal tool known as WHOA schemes,[77] which draw inspiration from both Chapter 11 and English schemes of arrangement. Throughout the book, references to other jurisdictions (e.g. Germany, Singapore) are made. These concise excursions aim to provide additional insights and perspectives on issues that may not exist or are less prominent in the chosen jurisdictions but remain of significant practical importance.

Fourth, this book draws valuable lessons from the post-financial crisis regulation of banks. In the aftermath of the Global Financial Crisis of 2008, the regulation of bank failures in various jurisdictions, including the EU and the USA, underwent fundamental changes.[78] These reforms were largely driven by the desire to effectively address collapses of credit institutions, prevent the need for bailouts, safeguard banks' critical functions, and ensure the stability of the financial system. To achieve this, it became imperative to supervise and resolve banks paying attention to their group structures. To the extent that bank regulation takes a group-sensitive approach (e.g. group resolution plans, group financial support agreements), it might assist us in finding the answers to various questions discussed in different chapters of this book. Yet we do not aim to exhaustively cover bank insolvencies and their regulation. Any in-depth examination of national insolvency or supranational bank resolution regimes deserves a book of its own.

Fifth, and finally, this book does not delve into the matters of private international law, such as international jurisdiction, recognition of foreign insolvency proceedings and insolvency-related judgments, and communication and cooperation between courts and IPs. The choice to exclude these matters does not mean that they are less important or deserve less attention than those considered in this book. On the contrary, in other academic works by the author, it is argued that the ability to deal with group financial distress in a centralised or well-coordinated way is crucial to preserve and maximise enterprise value.[79] Furthermore, the effectiveness of some

---

77 Act on Court Confirmation of Extrajudicial Restructuring Plans (*Wet homologatie onderhands akkoord* or WHOA). The WHOA came into force on 1 January 2021 and added new articles on WHOA schemes to the Dutch Bankruptcy Act.

78 M. Haentjens and B. Wessels, Three Paradigm Shifts in Recent Bank Insolvency Law, Journal of International Banking Law and Regulation, Vol. 7, 2016, pp. 396-400.

79 See I. Kokorin, S. Madaus and I. Mevorach, Global Competition in Cross-Border Restructuring and Recognition of Centralized Group Solutions, Texas International Law Journal, Vol. 56, 2021, pp. 109-154; I. Kokorin, B. Wessels, Cross-Border Protocols in Insolvencies of Multinational Enterprise Groups, Edward Elgar Publishing, 2021; I. Kokorin, Contracting Around Insolvency Jurisdiction: Private Ordering in European Insolvency Jurisdiction Rules and Practices, in V. Lazić and S. Stuij (eds) Recasting the Insolvency Regulation: Improvements and Missed Opportunities, Asser Press, 2020, pp. 21-58.

of the tools analysed in this book, like third-party releases and extended enforcement stays, hinges on their cross-border recognition. The decision to exclude private international law issues is dictated by the fact that they rest on or are supported by a distinct set of legal principles, categorised by Bork as "jurisdictional" principles.[80] Among them are the principles of unity, universalism, mutual trust, cooperation and communication. In light of the book's focus on substantive national law and the balancing of "substantive" legal principles, for the purpose of maintaining coherence, it was decided to leave private international law matters outside the scope of the book.

This book has several aims.

First, it aims to *restate, compare and explain* insolvency law, as applied to intra-group financial arrangements. These aims can be termed "descriptive". In the sense used here, "restating" the law involves the description of legal rules; "comparing" the law entails a comparison of legal rules in different jurisdictions; "explaining" the law refers to the examination of legal principles underpinning these rules. All three aims are free from any evaluative judgments. There is an increasing number of studies describing the problems characteristic of group insolvencies and the rules enacted to solve them.[81] This book draws on these studies. It describes different types of groups, outlines relevant legal principles, studies their manifestation in group insolvencies, looks into common intra-group financial arrangements, and investigates their treatment in insolvency laws of the UK, the USA and the Netherlands. Accomplishing these "descriptive" aims should help us better understand the law as it currently stands, and thus it is a necessary step towards achieving the second category of aims.[82]

Second, the book aims to *evaluate* and *normatively assess* the law in the given context. These aims could be termed "normative", as they seek to evaluate the current state of law and make general suggestions or recommendations. Such suggestions and recommendations are not targeted at any specific legislator or jurisdiction. Rather, they offer general guidance from a supra-

80 R. Bork, Principles of Cross-Border Insolvency Law, Intersentia, 2017.

81 C. Thole, M. Dueñas, Some Observations on the New Group Coordination Procedure of the Reformed European Insolvency Regulation, International Insolvency Review, Vol. 24, 2015, pp. 214-227; A. de Soveral Martins, Groups of companies in the Recast European Insolvency Regulation: Around and about the "group", International Insolvency Review, Vol. 28, 2019, pp. 354-362; T. Kostoula, Cross-Border Insolvency of Groups of Companies Under the Regulation (EU) 2015/848, European Company Law, Vol. 16, 2019, pp. 74-82; D. Zhang, Preventive Restructuring Frameworks: A Possible Solution for Financially Distressed Multinational Corporate Groups in the EU, EBOR, Vol. 20, 2019, pp. 285-318.

82 S. Smith, Contract Theory, OUP, 2004, p. 5, noting that "[b]efore attempting to reform the law, reformers must understand the law that they are planning to reform. Indeed, once the theoretical foundations of the law are understood, it is usually a short step to suggesting reforms of that law."

national perspective, which can be relied on to shape or enhance national laws or even international soft law instruments like the UNCITRAL legislative guides on insolvency law. By incorporating these normative aims, the book aspires to contribute to the advancement and improvement of insolvency law across different legal systems.

1.4 Organisation of This Book

This book is divided into six parts.

Part I. "Introduction" comprises the present Chapter 1. It introduces the reader to the subject, aims and scope of this book. Additionally, it sets the scene by describing three "benchmark" insolvency cases – Lehman Brothers, Nortel Networks and Oi Brazil. These cases exemplify the problems and complexities created by intra-group financing in insolvency.

Part II. "Enterprise groups: their life and death" introduces groups of companies. It presents a descriptive account of what defines a group, elucidates its common characteristics and various types. It shares some historical insights into the emergence of modern multinational enterprise groups and explores one of the most important concepts in company and insolvency law – limited liability. This part is integral to the overall thesis of this book. It sets the stage for further discussions and helps to better grasp the problems underpinned by group economic and legal structures.

Chapter 2 takes a closer look at the phenomenon of enterprise groups, tracing their gradual appearance and proliferation, from the emergence of internationally integrated and privately owned manufacturing firms to the adoption of truly global production chains by multinational enterprises and a marked shift from manufacturing towards the service economy. This chapter explores the key economic and legal prerequisites and facilitators of the formation of enterprise groups. It contextualises the discussion in the subsequent chapters, which will address specific issues and problems of intra-group financing.

Chapter 3 describes how insolvency law tackles financial distress within enterprise groups and how it has evolved over time. The Global Financial Crisis of 2008 and the rise of the so-called rescue culture facilitated this evolution and prompted the adoption of group-mindful solutions and tools. The aim of this chapter is to introduce the key restructuring procedures available in the UK, the USA and the Netherlands, highlight the progression of insolvency law and to show the limitations of a single enterprise approach. One such limitation is that insolvency law rarely interferes with the core of entity separateness and tends to preserve limited liability and entity shielding.

Part III. "Principles of insolvency law and how to balance them" builds a theoretical foundation for the analysis of intra-group financial arrangements and enterprise group insolvency.

Chapter 4 lays down the analytical framework used in this book. It explains the principle-based approach, defines a legal principle, and identifies the legal principles most relevant in the context of enterprise group insolvency. It first outlines three categories of legal principles and then discusses whether the principles of insolvency law and restructuring law are the same.

Chapter 5 develops a conceptual framework embraced to investigate conflicts between legal principles. The goal is to examine benchmarks that can be used to resolve these conflicts. For this purpose, we explore (i) the notion of fairness, (ii) the relative weight of legal principles, and (iii) meta-principles. While the categories of fairness and weight may not always serve as reliable benchmarks, proportionality is universal and can be applied to determine a balanced outcome in cases where legal principles clash.

Part IV. "Intra-group financing and insolvency: transactions and problems" is one of the core parts of this book, because it provides a foundation for evaluation and normative suggestions. It serves a dual purpose. First, it describes the financial arrangements commonly found in groups of companies, including intercompany guarantees, co-debtorship, intra-group loans and centralised cash management. Second, it analyses the benefits of intra-group financing and underscores the problems which such financing, along with applicable rules, may pose for efficient group insolvency and restructuring. Potential solutions to these specific problems will be explored later in Part V.

Chapter 6 examines a financial arrangement that is common to most enterprise groups, namely cross-guarantees. The purpose of this chapter is threefold. First, it investigates the reasons for entering into cross-guarantees and similar arrangements (e.g. co-debtorship) and covers some law & economics explanations, including the agency cost of debt, the impact on access to finance, and the level of risk-taking (i.e. ex ante effects). Second, it highlights and explains how cross-guarantees and similar arrangements give rise to various rights and obligations between a principal debtor, a guarantor (or co-guarantors) and a creditor – what we call the "triangle of rights and liabilities". The existence and enforceability of these rights and liabilities have direct consequences for the efficiency of restructuring proceedings. Third, we uncover the problems and challenges that cross-guarantees create in insolvency (i.e. ex post effects).

Chapter 7 logically follows the previous chapter and examines the mechanisms that involve the re-allocation of liquidity within an enterprise group once financing has been acquired from third parties and is then "transported" from one group entity to another. This financing can take the form

of a single intra-group loan or the on-going redistribution of funds through a centralised cash management or cash pooling system. The key question here is whether claims of insiders (e.g. group members) are and should be subordinated in insolvency. No signs of consensus seem to appear on this divisive issue, either in academic literature or in law. This chapter summarises arguments in favour and against the subordination of insider loans and highlights the most serious critique of subordination related to underinvestment.

Chapter 8 focuses on insolvency transaction avoidance. It poses a pivotal question of whether a certain transaction, such an intercompany guarantee, is avoidable in insolvency and whether "group considerations" play a role in this decision. Based on comparative analysis, it concludes that in all three jurisdictions, cross-guarantees present substantial problems for transaction avoidance law, because they are often driven by group considerations or group interest and may not entail clear and direct benefits to individual guarantors. The chapter puts together the difficulties of ex post substantive review and argues that legal uncertainty is inherent in the review of transactions involving group members.

Chapter 9 explores contractual clauses that are common in financial transactions, including those based on loan and bond documentation of the Loan Market Association (LMA). These clauses grant a creditor special termination, amendment, or acceleration rights – ipso facto and cross-default clauses. This chapter (i) explains the rationale and operation of ipso facto and cross-default clauses, (ii) highlights their alarming traits and effects on early crisis responses and the resolution of financial distress within enterprise groups, and (iii) discusses how different jurisdictions, including the UK, the USA and the Netherlands, grapple with these contractual provisions in pursuit of a balance between protecting freedom of contract and party autonomy, on the one hand, and ensuring the preservation of value and efficient restructuring of viable enterprises, on the other hand.

Part V. "Group sensitive insolvency law: tools and solutions" analyses potential solutions to the problems arising from or connected to intra-group financing for efficient resolution of financial distress within enterprise groups. It explores various legal tools that have emerged in response to the economic reality of enterprise groups and to the patterns of their failures. They include third-party releases, extension of enforcement stays to entities within the group, and the suspension or unenforceability of certain contractual clauses. The discussed tools embrace the so-called "extension effect". However, one needs to be careful with the application of such tools, because they often encroach on various legal principles, resulting in conflicts between them. The aim of this part, and in fact, the entire book, is to develop suggestions on how law can address the challenges of intra-group financing and group insolvencies in a principled way.

Chapter 10 discusses group debt deleveraging and debt adjustment by means of a third-party release. The latter presents a group-mindful tool that allows the restructuring of obligations of third parties (e.g. group guarantors, co-debtors, collateral providers) via a single proceeding. Third-party releases have attracted heightened attention due to their use in high-profile bankruptcies dealing with mass tort claims, including Purdue Pharma. This chapter does not touch upon tort cases and instead focuses on transactions related to the attraction of funds. It examines the scope and requirements for releasing third parties (non-debtors) under laws of the UK, the USA and the Netherlands, and concludes with a summary of the main findings and a proposal of elements or considerations that may guide the design and application of rules on third-party releases.

Chapter 11 focuses on the rules on enforcement stays in the UK, the USA and the Netherlands, and discusses whether law permits their extension to non-debtor parties (e.g. group guarantors or co-debtors) who are not themselves subject to insolvency or restructuring proceedings. It makes suggestions on when a group-wide extension of an enforcement stay might be desirable and under what conditions.

Chapter 12 is devoted to rescue financing, specifically to intra-group rescue financing. It is common for a struggling company to be in dire need of cash. A failure to obtain financing may trigger cross-defaults, cause a breakup of commercial ties with critical suppliers, complicate negotiations with creditors, and disrupt potential reorganisation efforts. The situation is aggravated by high commercial and legal risks involved in providing funds to or extending a guarantee in favour of a distressed company. In a group context, intra-group financing is further coloured with transaction avoidance and claim subordination risks. This chapter analyses two strategies which may supplement the ex post judicial review, namely (i) ex ante authorisation of a transaction (so called "safe harbour"), and (ii) preemptive financial arrangements used in banking groups. Like the previous chapters in this part, it concludes with an overview of main findings and suggestions.

Chapter 13 questions whether the limits imposed by law on freedom of contract – constraints related to the enforceability of ipso facto and cross-default clauses – apply and should apply to intercompany ipso facto and cross-default clauses. The goal is first to probe whether law, as adopted in the relevant jurisdictions, provider for a possibility to extend its protective rules to contracts concluded by debtor's affiliates, and second, on a more normative side, to examine and make suggestions on whether and under what circumstances such an extension would be desirable and proportionate.

Part VI. "Conclusion", contained in Chapter 14, summarises the key findings of this book and concludes with some final observations and thoughts.

Part II

Enterprise Groups: Their Life and Death

2 Phenomenon and Rise of Multinational Enterprise Groups▪

2.1 Introduction

This chapter introduces multinational enterprise groups – key actors explored in this book. There are various theories which try to explain the emergence and the continued dominance of corporate groups (network theory, agency theory, etc.). A group structure can be seen as a response to a negative outside environment (e.g. underdeveloped external markets) and as a facilitator of economic growth and wealth accumulation (e.g. improved risk management, lower transaction costs and efficient allocation of resources).[1] This chapter does not aim to discuss all factors that might have contributed to the rise of enterprise groups. Our inquiry is mainly legal and, to some extent, historic and economic.

Section 2.2. examines the emergence of groups of companies as a way of organising and conducting business. It is noted that what is known today as an enterprise group is a relatively recent invention. It should be distinguished from other related but separate phenomena, such as: (i) legal personhood – recognition of a legal personality, separate from its shareholders; (ii) limited liability – protection of shareholders' assets from the claims of the company's creditors; and (iii) entity shielding – protection of the company's assets from the claims of shareholders' creditors. Section 2.3. addresses the definition of an enterprise group and underlines its most common constitutive elements. Section 2.4. investigates different characteristics and types of enterprise groups. Section 2.5. analyses possible reasons why a group structure has become one of the most prevalent forms of a business organ-

---

▪ This chapter builds upon the following previously published work by the author:
– Kokorin, Contracting Around Insolvency Jurisdiction: Private Ordering in European Insolvency Jurisdiction Rules and Practices, in V. Lazic and S. Stuij (eds), Recasting the Insolvency Regulation: Improvements and Missed Opportunities. Short Studies in Private International Law, Asser Press, 2020, pp. 35-40.

1 For an overview of value-creation-based explanations for the existence of a group organisational form, see L. Enriques and S. Gilotta, The Case Against a Special Regime for Intragroup Transactions, ECGI Law Working Paper No. 641/2022, May 2022, pp. 11-15; G.G. Triantis, Organizations as Internal Capital Markets: The Legal Boundaries of Firms, Collateral, and Trusts in Commercial and Charitable Enterprises, Harvard Law Review, Vol. 117, 2004, p. 1112, observing that "[i]nternal capital markets play a greater role in capital reallocation when external capital markets are less developed and when significant information asymmetry impedes external finance."

isation. This inquiry will touch upon the economic rationale underpinning the existence of enterprise groups and the centrality of limited liability and entity shielding for their operation. This inquiry is important in view of the consequences that limited liability and entity shielding, underpinning asset partitioning, have on the treatment of group entities and their transactions in insolvency. Section 2.6. concludes.

2.2 History and Legal Foundations of Enterprise Groups

It is difficult, and maybe even impossible, to determine the exact date when enterprise groups have come into existence. One can find early precursors or prototypes of business groups in the way the Medici empire was set up in the 15th-16th centuries. The Medici family ruled over Florence from the 1430s to 1530s. Its businesses included banking, textile manufacturing and trade all over Europe. The Medici empire was organised as a system of partnerships, with a senior partnership based in Florence. The senior partnership held a controlling interest in junior partnerships and entered into separate agreements with junior partners who took charge of the local operations and received a share of profits. Commenting on this structure, De Roover wrote: "There are consequently two layers: a controlling partnership – the parent – and several tributary partnerships – the subsidiaries. Only this subspecies prefigures the modern holding company."[2]

However, the Medici enterprise was not a corporate group with separate group companies fully protected by the entity shields. De Roover describes a lawsuit tried before the court in Bruges in 1453.[3] It was brought against the acting manager of the Medici partnership in Bruges for defective packing of nine bales of wool purchased by the plaintiff from the London branch. The plaintiff argued that "the Medici branch in Bruges and the one in London were all one company and had the same master."[4] The court dismissed the claim on the basis that the London partnership should be the first one to take responsibility. Yet the plaintiff's right to sue the Bruges partnership was preserved. This case demonstrated what Hansmann et al. refer to as the "rule of weak entity shielding"[5] and the "location-based entity shielding."[6] Nevertheless, in many aspects (e.g. a common brand, in this case – the good name of the Medici, control from "headquarters"), the partnership-based system resembles present day multinationals.

2 R. De Roover, The rise and decline of the Medici Bank, 1397-1494, HUP, 1963, p. 77.
3 R. De Roover, The Medici Bank: Organization and Management, The Journal of Economic History, Vol. 6, 1946, p. 31.
4 Ibid.
5 H. Hansmann, R. Kraakman and R. Squire, Law and the Rise of the Firm, Harvard Law Review, Vol. 119, 2006, p. 1366.
6 Ibid., p. 1368.

Some authors trace the genesis of modern multinational enterprises to the colonial trading companies of the 17th century – the Dutch East India Company (*Vereenigde Oostindische Compagnie* or VOC) and the English East India Company (EIC).[7] Both companies engaged in long-distance oceanic trade and combined the idea of a separate legal personhood with joint-stock investment financing. Separate legal personality meant that the companies had their own distinct pools of assets and could enter into transactions on their own behalf.[8] They could own land, litigate in court and hold franchises. In addition to legal personhood, these companies manifested a feature of "shareholder lock-in", meaning that shareholders could not redeem their shares (i.e. take out their initial contribution) at any time they wanted. This laid down "the foundation for durable asset pools that could grow and produce wealth indefinitely […]."[9] Still, shareholders could sell their shares on the vibrant secondary market that ensured liquidity for the locked-in capital. The secondary markets in shares were booming.

Notably, separate legal personality and shareholder lock-in did not signal the presence of either limited liability or a group structure. It remains disputable whether early business corporations embraced the concept of limited liability. Gelderblom et al. argue that the VOC had transferable shares and limited liability for shareholders from the outset.[10] Harris challenges this view and emphasises that the Dutch East India Company had

---

7 A.M. Carlos and S. Nicholas, "Giants of an Earlier Capitalism": The Chartered Trading Companies as Modern Multinationals, The Business History Review, Vol. 62, 1988, pp. 398-419.

8 The corporate form was originally, up until the 16th century, employed for public and semi-public purposes (e.g. municipalities, monasteries) and only a partnership served as a viable form for organising business affairs. R. Harris, Industrializing English Law: Entrepreneurship and Business Organization, 1720–1844, CUP, 2000, p. 21. See also D. Graeber, Debt: The First 5,000 Years, Melville House Publishing, 2011, p. 304, noting that the "legal idea of a corporation as a "fictive" person […] was first established in canon law by Pope Innocent IV in 1250 AD, and one of the first kinds of entities it applied to were monasteries – as also to universities, churches, municipalities, and guilds."

9 K. Pistor, The Code of Capital: How the Law Creates Wealth and Inequality, Princeton University Press, 2019, p. 66. The lock-in capital feature was first applied in the VOC and only later in the EIC. This is believed to be one of the reasons why the VOC outperformed the EIC for a number of decades. See G. Dari-Mattiacci, O. Gelderblom, J. Jonker, E.C. Perotti, The Emergence of the Corporate Form, The Journal of Law, Economics, and Organization, Vol. 33, 2017, p. 196.

10 O. Gelderblom, A. de Jong and J. Jonker, The Formative Years of the Modern Corporation: The Dutch East India Company VOC, 1602–1623, The Journal of Economic History, Vol. 73, 2013, p. 1051; M. Prak and J.L. van Zanden, Pioneers of Capitalism, Princeton University Press, 2022, p. 122, claiming that the VOC "exemplified the new capitalism that was taking shape around 1600. […] For the first time, we see the limited liability company emerging as a new business entity, the trading of company shares, speculation in these shares on a stock exchange, conflicts between shareholders and management over the policy of the new company – all rooted in the "modern" separation between ownership and management of a company."

two classes of shareholders – passive shareholders (*participanten*) and active shareholders (*bewindhebbers*). According to Harris, while the liability regime of the former was not defined in the charter or elsewhere, the latter assumed personal liability.[11] There is no need to take sides in this debate. What is more crucial is to point out that even though the early inter-continental trading companies had complex governance structures, they were hardly groups of companies in the modern sense. Instead, most shareholders were merchants and regular citizens.[12] The recognition of a company as a legal person with transferable shares, being the foundation of "entity law", was not necessarily the foundation of "group law".

The emergence of conglomerates of companies linked through control or significant ownership – enterprise groups – comes after the recognition of legal personhood and after the crystallisation, if not the universal acceptance, of the idea of limited liability.[13] Many historians and economists consider that modern multinational enterprises developed in the mid- to late 19th century.[14] This period was characterised by the advent of new industrial technologies, improvements in manufacturing and management

11 R. Harris, A new understanding of the history of limited liability: an invitation for theoretical reframing, Journal of Institutional Economics, Vol. 16, 2020, p. 646. Harris describes three historical periods in the formation of limited liability and states that limited liability, in the present-day sense, became a uniform attribute of corporations only in the 20th century. He attributes this development to the establishment of corporate insolvency and liquidation procedures and the proliferation of debt finance. Interestingly, Harris notes that limited liability was not a prerequisite for economic growth and the expansion of large businesses in the modern period of history.

12 P. Frentrop, The Dutch East India Company: the first corporate governance debacle, in T. Clarke, J. O'Brien and C.R.T. O'Kelley (eds), The Oxford Handbook of the Corporation, OUP, 2019, pp. 51-74.

13 For the history of limited liability, see S.M. Bainbridge, M.T. Henderson, Limited Liability: A Legal and Economic Analysis, Edward Elgar Publishing, 2016, observing that limited liability has ancient roots (the Roman legal device *peculium*), that it surfaced in the Middle Ages in the form of *commenda*, where passive investors enjoyed limited liability, and that it became more institutionalised in the 19th century (e.g. *société anonyme* under the Napoleonic *Code de Commerce* of 1807; the UK's Limited Liability Act of 1855 and the Joint Stock Companies Act of 1856; New York Act of 22 March 1811).

14 M. Wilkins, The History of the Multinational Enterprise, in A.M. Rugman (ed), The Oxford Handbook of International Business, 2nd edn, OUP, 2009, p. 16, arguing that the modern multinational firm is a "post-industrial revolution phenomenon" and that "[o]nly with steamships, railroads, and cables was it possible for managers to exercise control over business operations across borders in a meaningful manner." Also M. Wilkins, The Emergence of Multinational Enterprise: American Business Abroad from the Colonial Era to 1914, HUP, 1970; L. Franko, The European Multinationals: A Renewed Challenge to American and British Big Business, Harper and Row, 1976. For a comprehensive study of business groups in the developed economies of the West, see A.M. Colpan and T. Hikino (eds), Business Groups in the West: Origins, Evolution, and Resilience, OUP, 2018, p. 3, observing that "[b]usiness groups actually rose to function as a critical factor of industrial dynamics in the context of the Second Industrial Revolution in the late nineteenth century."

processes, and the international division of production. It was also when corporate laws of a number of jurisdictions were liberalised. One of the key characteristics of this process concerned the right of legal persons (companies) to own shares in other legal persons, without which multi-layered group structures could not have come into existence.

For contemporary lawyers, it may seem self-evident that companies can create other companies, acquire and own shares in them. However, it has not always been the case. Describing the American experience, Blumberg observes that "[i]n the absence of an express provision in the statute or charter, it was settled that acquisition by one corporation of another corporation's shares was *ultra vires*."[15] In the USA, New Jersey was one of the first states to amend its corporation laws in 1888-1893 to provide for corporate ownership of shares. Other states followed suit, although by 1910 only thirteen of them had similar laws.[16] Gradually, intercorporate stockholding became widely recognised. This gave rise to groups of companies that expanded their operations nationally and internationally.[17] Most of these groups had a pyramidal structure. The building of corporate pyramids was driven by the policy of the states, many of which required local chartering of regulated industries, including insurance, banking and utility companies. The incorporation of local subsidiaries was a pathway to circumvent the states' protectionist requirements.[18]

Corporate ownership of shares in another company was a late arrival in the UK too. Historically, it was believed that a company, being an artificial person, lacked the legal capacity to own shares. The change occurred in the mid-19th century, when the power of intercompany stock ownership was attributed to the provisions of memoranda of association, notwithstanding the omission of the express recognition of such power in incorporation statutes. English courts held in the 1860s that neither the common law nor the Companies Act of 1862 prohibited companies from acquiring and owning shares in other companies, should the memorandum of association so prescribe.[19] That being said, it was not until the 1890s that corporate groups

---

15 P. Blumberg, Limited Liability and Corporate Groups, The Journal of Corporation Law, Vol. 11, 1986, p. 606. Note that such special legislative enactment or charter provision was virtually never granted to manufacturing companies.

16 F. Freedland, History of Holding Company Legislation in New York State: Some Doubts as to the "New Jersey First" Tradition, Fordham Law Review, Vol. 24, 1955, pp. 369-411.

17 M.J. Roe, Corporate Strategic Reaction to Mass Tort, Virginia Law Review, Vol. 72, 1986, p. 47, arguing that "[a]uthority to own subsidiaries was a device to facilitate molding the disparate local companies into a nationwide enterprise."

18 M. Pargendler, The Grip of Nationalism on Corporate Law, Indiana Law Journal, Vol. 95, 2020, p. 566.

19 *In re Barned's Banking Company* (1867) 3 LR Ch 105, 112-13; R*e Asiatic Banking Corporation* (1868-69) LR 4 Ch App 252 at 257; *The Gramophone and Typewriter Ltd v. Stanley* [1908] 2 KB 89, affd *The Gramophone and Typewriter Ltd v. Stanley* [1906] 2 KB 856. C. Witting, Liability of Corporate Groups and Networks, CUP, 2018, pp. 65-66.

began to take shape in the UK. This development was largely linked to the merger activity aimed at the reduction of competition and price increase. Unlike their US counterparts, these early groups were "more in the nature of loose federations than integrated corporations".[20] It was the 1920s-1930s when corporate groups entered "the conscious jurisprudence of UK company law."[21]

As to continental Europe, there seems to have been no general prohibition of intercorporate stockholding. As a result, various group structures took shape.[22] Commenting on the German experience, Van Oostrum notes that the growing economic concentration and power of group enterprises in the mid- and late 19th century prompted the crystallisation of group law.[23] A group structure was utilised by Siemens, Europe's primary producer of telegraphic equipment, which diversified its production by setting up subsidiaries for different lines of business (e.g. electro-chemicals, telephone equipment, fertilizers) and building joint ventures like Telefunken, created to develop wireless telegraphy.[24] However, the proliferation of group structures in Germany only occurred in the 1920s, during the period of the Weimar Republic. At that time, the number of stock corporations (AGs) rose explosively, indicating an increase in the number of corporate groups.[25] Kuntz confirms that corporations actively invested in shares, "building groups or at least holdings of large blocks of stock."[26] The first definition of a group in German company law appeared in 1937,[27] while the standalone regulation of groups – the well-known *Konzernrecht* – was introduced in 1965.[28]

---

20 P. Lipton, The Mythology of Salomon's Case and the Law Dealing with the Tort Liabilities of Corporate Groups: An Historical Perspective, Monash University Law Review, Vol. 40, 2014, p. 475.

21 I. Mevorach, Insolvency within Multinational Enterprise Groups, OUP, 2009, p. 11, referring to T. Hadden, Inside Corporate Groups, International Journal of the Sociology of Law, Vol. 12, 1984, pp. 271-286.

22 T. Hadden, Regulating Corporate Groups: An International Perspective, in J. McCahery, S. Picciotto and C. Scott (eds), Corporate Control and Accountability, Oxford: Clarendon Press, 1993, p. 343 and pp. 350-351.

23 C.H.A. van Oostrum, Regres bij concernfinanciering (Serie Van der Heijden Instituut nr. 156) (diss. Leiden), Deventer: Wolters Kluwer, 2019, p. 232.

24 A.D. Chandler, Scale and Scope: The Dynamics of Industrial Capitalism, HUP, 1994, p. 466.

25 F. Hoffmann, Konzernhandbuch, Wiesbaden: Gabler, 1993, p. 61.

26 T. Kuntz, German corporate law in the 20th century, in H. Wells (ed), Research Handbook on the History of Corporate and Company Law, Edward Elgar Publishing, 2018, p. 207.

27 *Gesetz über Aktiengesellschaften und Kommanditgesellschaften auf Aktien*, 1937, § 15(1).

28 The adoption of the Stock Corporation Act (*Aktiengesetz*), dealing with stock corporations (*Aktiengesellschaft*). A. Scheuch, *Konzernrecht*: An Overview of the German Regulation of Corporate Groups and Resulting Liability Issues, European Company Law, Vol. 13, 2016, pp. 191-198.

The industrial revolution prompted the development of enterprise groups in the Netherlands. While some business groups trace their origin to the late 19th century, at that time, the majority of companies remained small-scale and family-owned.[29] The early 20th century saw a spike in the merger activity, giving rise to famous names. For example, in 1929, Dutch Margarine Union merged with the British soap manufacturer Lever Company to form Unilever Group (Unilever). Until 2020, Unilever had a dual-parent holding company structure with Unilever PLC (the UK) and Unilever N.V. (the Netherlands).[30] In 1890, a number of Dutch entrepreneurs founded the Royal Dutch Petroleum Company, which focused on the sale of petroleum in East Asian markets. This company merged with British Shell Transport and Trading Company Limited in 1907 – a move dictated by competition with American Standard Oil. Until recently, Shell had a dual nationality and organisational structure. In 2005, its shareholders supported the unification of Shell's Dutch and UK parent companies under a single parent company, Royal Dutch Shell plc.

The history of enterprise groups is closely interwoven with economic and political history.[31] This is because group operations are often international and dependent on political processes. They are also affected by technological inventions and market developments. The rise of modern groups in Europe and the USA dates back to the late 19th and the beginning of the 20th century. This was the time of the expansion of foreign direct investment and the establishment of cross-border operations. The technological progress, including the invention of telegraph and telephone, promoted the integration and centralisation of group structures.[32] Skeel notes that America's first

---

29 For a study of Dutch business groups in 1903-2003, see F. De Goey and A. De Jong, The Netherlands: The Overlooked Variety of Big Businesses, in A.M. Colpan, T. Hikino (eds), Business Groups in the West: Origins, Evolution, and Resilience, OUP, 2018, pp. 165-192.

30 For background and reasons for the unification, see Form F-3 Registration Statement under the Securities Act of 1933 <https://www.sec.gov/Archives/edgar/data/110390/000110465920094571/tm2027199-1_f3asr.htm> (accessed 15 July 2023).

31 For a study of multinational enterprises, see P. Muchlinski, Multinational Enterprises and the Law, 2nd edn, OUP, 2007 and P. Muchlinski, Multinational Enterprises and the Law, 3d edn, OUP, 2021. Note that the term "multinational enterprise" as used by Muchlinski, is broad and does not entail a specific form of a corporate structure or the juridical form of an enterprise. This is why it should be distinguished from an enterprise group – a term that implies a certain pattern of ownership and control.

32 Before the 19th century, enterprises were largely organisationally decentralised. This was the case of the EIC, whose multi-divisional nature – a separation of powers between the board of directors and relatively independent overseas managers (factors), was highlighted in a number of studies. See E. Erikson, Between Monopoly and Free Trade: The English East India Company, Princeton University Press, 2014; G.M. Anderson, R.E. McCormick, R.D. Tollison, The economic organisation of the English East India Company, Journal of Economic Behavior and Organization, Vol. 4, 1983, p. 226, noting that the "Central Office was too far removed from the Indies to do much more than endorse decisions already made by its chief factors or to sanction decisions of which it disapproved."

large-scale business enterprises, the railroads, brought many units carrying on different types of economic activities under their control and adopted hierarchical business structures, "with a class of middle managers between the railroad's workers and its executive officers."[33] Hadfield describes this "old" economy as the "economy of consolidation and vertical integration, the absorption of economic activity in entire industries within the walls of a handful of, maybe even a single, corporation."[34] According to Hadfield, this is the "world of General Motors, U.S. Steel, AT&T, and, eventually, IBM."[35]

The 1990s witnessed the deepening of global production and supply chains, a shift from raw materials and manufacturing towards the service economy and liberalisation of trade and investment regimes. Interestingly, unlike the technological advancements of the 19th century, the current technological progress pulls in the opposite direction by instilling decentralisation.[36] The ease with which information is accessed and disseminated across the globe simplifies access to corporate decision-making and corporate ownership. Another "decentralising" factor arises from the operation of platform-based businesses and their asset base. Baird points out that, "[f]ew businesses today center around specialized long-lived assets. In a service-oriented economy, the assets walk out the door at 5:00 pm."[37] One might argue that "assets-light" and platform-based businesses have fewer incentives to adopt hierarchical or pyramidal corporate structures that have prevailed over the 20th century. Decentralisation is further promoted by the advent of distributed ledger technology, including blockchain, which empowers the creation of decentralised autonomous organisations (DAOs).[38] This may boost new models of industrial and legal organisation.

---

33 D.A. Skeel, Icarus in the Boardroom: The Fundamental Flaws in Corporate America and Where They Came From, OUP, 2005, p. 25.

34 G. Hadfield, Legal Infrastructure and the New Economy, I/S: A Journal of Law and Policy for the Information Society, Vol. 8, 2012, p. 12.

35 Ibid.

36 M.J. Roe, Three Ages of Bankruptcy, Harvard Business Law Review, Vol. 7, 2017, p. 215, suggesting that while collective bankruptcy proceedings are needed for industries comprised of big, vertically integrated firms, they may lose appeal in the case of decentralised organisational structures.

37 D.G. Baird, The New Face of Chapter 11, American Bankruptcy Institute Law Review, Vol. 12, 2004, p. 82.

38 See I. Kokorin, Contracting Around Insolvency Jurisdiction: Private Ordering in European Insolvency Jurisdiction Rules and Practices, in V. Lazic and S. Stuij (eds.), Recasting the Insolvency Regulation: Improvements and Missed Opportunities. Short Studies in Private International Law, Asser Press, 2020, pp. 35-40. For rather sceptical views on whether blockchain is capable of transforming the corporate form, see K.F.K. Low, E. Schuster and W.Y. Wan, The Company and Blockchain Technology, LSE Legal Studies Working Paper No. 18/2022, 29 October 2022 <https://ssrn.com/abstract=4258114> (accessed 15 July 2023).

2.3 Defining an Enterprise Group

Despite the proliferation of multinational enterprise groups and the significant economic power they hold nowadays, there is no universal legal definition of an enterprise group.[39]

For instance, Dutch law adopts the approach that embraces the economic reality of groups of companies. Under the Dutch Civil Code (*Burgerlijk Wetboek* or BW), a group is defined as "an economic unit in which legal persons and partnerships are organisationally interconnected."[40] It specifies that group entities are legal persons and partnerships connected to each other in one group.[41] From the definition of a group, we can conclude that two criteria are of relevance: (i) economic unity, and (ii) organisational connection.

"Economic unity" entails an economic bond between companies within the group. This may be observed in external communication, joint reporting, consolidated annual accounts, a common financial and economic policy, intra-group financing, a 403-statement (section 6.5.2.3.3.) and the dependence of group entities on each other. These characteristics serve as points of reference, and their absence does not necessarily mean that there is no economic unit.[42] "Organisational connection" indicates a certain degree of integration within the group structure. This integration could take various forms and degrees, and may arise from capital participation, membership rights or an agreement that makes it possible to exercise control rights.

From legislative history, the third element can be deduced, that is (iii) centralised management (*centrale leiding*).[43] In practice, there can be varying degrees of such centralised direction and autonomy of individual group companies. Yet this element suggests the existence of some central decision-making on a joint strategy and hierarchy between group members, making

39 On the problem of defining a corporate group, see S. Pepels, Defining groups of companies under the European Insolvency Regulation (recast): on the scope of EU group insolvency law, International Insolvency Review, Vol. 30, 2021, pp. 96-123.

40 Dutch Civil Code, Article 2:24b.

41 Ibid. Foreign legal entities can also form part of a group.

42 J. van der Kraan, Toepassing en rechtskarakter van de groepsvrijstelling van artikel 2:403 BW (Serie Van der Heijden Instituut nr. 171), Deventer: Wolters Kluwer 2022, 3.3.2.

43 *Kamerstukken II* 1979/80, 16 326, nr. 3, MvT, p. 42, noting that the bond between group members would usually find expression in capital participation, "in view of the control required to act as a unit, this participation will generally be a – direct or indirect – majority shareholding; 50% and minority shareholdings will only lead to group membership if the shareholding is reinforced with special rights, otherwise the participating company will not be able to continue its leadership with a decisive vote." *Kamerstukken II* 1987/88 19 813, nr. 5, MvA, punt 14, zie voorts art. 2:406, aant. 2.1. Since 2005, the concept of central management can be found in a closely related provision concerning consolidated annual accounts (Article 2:406 BW).

it possible to implement a common group strategy.[44] A necessary complement of, but not the only requirement for, central management is that it must be able to be "imposed", if necessary, against the will of the directors of subordinate companies.[45]

There is a connection between these three criteria. After all, economic unity presupposes a certain organisational connection that is established under central leadership.[46] This is why it is argued that companies connected through a franchise agreement may not constitute a group, since both central management and economic unity could be weak or absent. In most cases, the franchisor is not responsible for and does not take a share in the business of his franchisees.[47] Equally, a pure investment company that holds shares in another company may not be associated with that company in a group, because the element of central management (planning, coordination and control of the policy of subsidiaries) might be missing.[48]

The German Stock Corporation Act (*Aktiengesetz* or AktG) provides that "where a controlling enterprise and one or several controlled enterprises are combined under the common management of the controlling enterprise, they form a group."[49] The key element defining a group is therefore control, which is manifested in the ability to "directly or indirectly exert controlling influence."[50] Control exists if group members have entered into a control agreement (*Beherrschungsvertrag*) and is presumed if one legal entity holds the majority stake in another legal entity.[51] This is a situation of a vertical group, structured in a pyramidal hierarchical form. This group type is reflected in the definition of a corporate group given by Blumberg, according to which a group is an enterprise "organized in the form of a dominant

44 Asser/Kroeze 2-I 2021/261.
45 Ibid.
46 M. Olaerts, GS Rechtspersonen, commentaar op art. 2:24b BW.
47 S. Bartman, A. Dorresteijn & M. Olaerts, Van het Concern, Wolters Kluwer, 2020, 2.2.1.
48 Asser/Maeijer, Van Solinge & Nieuwe Weme 2-II* 2009/816.
49 Stock Corporation Act of 6 September 1965 (Federal Law Gazette I, p. 1089), § 18.
50 AktG, §17(1). The Federal Court of Justice (*Bundesgerichtshof* or BGH) emphasised that "controlling influence" should at least in part be conveyed by means of company law and not solely through economic links. BGH, Urteil vom 26-03-1984 - II ZR 171/83. On the regulation of corporate groups in German law, see A. Cahn and D.C. Donald, Comparative Company Law: Text and Cases on the Laws Governing Corporations in Germany, the UK and the USA, 2nd edn, CUP, 2018, pp. 834-840. The ability to exercise the dominant influence over another undertaking characterises a parent undertaking for the purposes of prudential supervision and accounting under EU banking legislation. See e.g. Article 4(15) of the Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms.
51 AktG, §17(2). Also, A. Scheuch, Konzernrecht: An Overview of the German Regulation of Corporate Groups and Resulting Liability Issues, European Company Law, Vol. 13, 2016, pp. 191-198.

parent corporation with scores or hundreds of subservient sub-holding, subsidiary, and affiliated companies."[52] The AktG also states that if "legally separate enterprises are subject to common direction, although none of such enterprises controls the other, such enterprises shall constitute a group and the individual enterprises shall constitute members of such group."[53] This is the case of a horizontal or heterarchical group, in which legal entities could enjoy more autonomy, and the group as a whole may operate in a more decentralised way.[54]

The UK's Companies Act 2006 recognises two main types of corporate groups: (i) parent and subsidiary undertakings, relevant primarily for accounting purposes, and (ii) a holding company and its subsidiaries, used in other statutory contexts. For the first type, the law obliges parent companies, incorporated in the UK (with certain exceptions), to produce annual consolidated group accounts.[55] These group accounts should encompass subsidiary undertakings and give creditors and shareholders a clear picture of the group's performance. An undertaking is considered a parent undertaking if it holds a majority of voting rights in another undertaking (subsidiary), has a participating interest in that undertaking, and can appoint or remove the majority of its board members. Also, a parent and subsidiary undertaking relationship exists where a parent undertaking has the right to exercise dominant influence over the subsidiary, either by virtue of the provisions contained in the undertaking's articles or through a control contract (legal control),[56] or where it has the power to exercise or actually exercises dominant influence over a subsidiary (factual control).[57]

Outside the accounting context – for general purposes – the "scope" of a group may often be relevant as well. For example, under English law, a subsidiary is prohibited from holding shares in its parent (holding) company.[58] Determination of a group can also be important in calculating various types of tax liability and even for commercial contractual construction.[59] The

52 P. Blumberg, The Transformation of Modern Corporation Law: The Law of Corporate Groups, Connecticut Law Review, Vol. 37, 2005, p. 606, noting that group enterprises "typically conduct a single integrated enterprise under common control and often under a common public persona."

53 AktG, §18(2).

54 I. Mevorach, Insolvency within Multinational Enterprise Groups, OUP, 2009, p. 19.

55 Companies Act 2006, sections 399-402.

56 Companies Act 2006, section 1162(1), (2), (3). A control contract functions like German *Beherrschungsvertrag*.

57 Companies Act 2006, section 1162(4).

58 Companies Act 2006, section 136.

59 *Enviroco Ltd v. Farstad Supply A/S* [2011] 1 WLR 921. The case concerned interpretation of an indemnity clause, which covered "affiliates", being defined by reference to a "subsidiary" under the Companies Act 1985.

definition applicable for non-accounting purposes is largely similar (e.g. majority of voting rights, right to appoint or remove a majority of the board of directors),[60] but seems to be narrower. This is because the tests for the existence of a corporate group based on legal and factual control do not apply with respect to the second type of corporate groups.[61]

So far, our overview of laws addressing the concept of a group has touched upon commercial, company, or accounting legislation. The definition of an enterprise group can also be found in insolvency-specific rules, even though these rules are rare. The EIR Recast defines a "group of companies" as a "parent undertaking and all its subsidiary undertakings."[62] The "parent undertaking" means "an undertaking which controls, either directly or indirectly, one or more subsidiary undertakings."[63] In a similar, inclusive manner, the BRRD and the SRMR define a group as a "parent undertaking and its subsidiaries."[64] The MLEGI refers to "two or more enterprises that are interconnected by control or significant ownership,"[65] with control being the "capacity to determine, directly or indirectly the operating and financial policies of an enterprise."[66]

In sum, a "group" does not have a single definition and may even be defined differently in the same jurisdiction, depending on the purpose and relevant area of regulation (tax, accounting, competition, company, insolvency). That said, control and share ownership often determine the existence of a corporate group. However, the degree of autonomy within an enterprise and the strength and significance of centralised direction or a group-wide strategy may vary from one group to another. Limiting the definition of an enterprise group to a particular degree of control or stock holding, whether direct or indirect, of a specified percentage of capital or votes may be counterproductive. It inevitably creates a mismatch between law and economic reality, allows some groups to avoid legal consequences, and deprives other groups of many benefits and tools, available under

60 Companies Act 2006, section 1159.

61 E. Ferran, L.C. Ho, Principles of Corporate Finance Law, 2nd edn, OUP, 2014, p. 26; R. Valsan, National Report on the United Kingdom, in R.M. Manóvil (ed), Groups of Companies: A Comparative Law Overview, Springer, 2020, p. 631.

62 EIR Recast, Article 2(13).

63 EIR Recast, Article 2(14).

64 BRRD, Article 2(26); Regulation (EU) No 806/2014 of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund (SRMR), Article 3(23).

65 MLEGI, Article 2(b).

66 MLEGI, Article 2(c). Definitions of an "enterprise group" and "control" are derived from the UNCITRAL Legislative Guide, Part three.

insolvency law.[67] A more inclusive approach is therefore appropriate. The adoption of this approach does not mean that all groups should be treated in the same way. Quite the opposite.

2.4 Characteristics and Types of Enterprise Groups

Enterprise groups are distinct from each other.[68] Group structures have different shapes and sizes, ranging from colossal worldwide-operating multinationals, such as Lehman Brothers, Nortel Network, Royal Dutch Shell and Unilever, to groups consisting of a parent company and one subsidiary, incorporated and operating in the same country. Enterprise groups diverge in terms of their corporate and operational structures, ways of group financing, management and ownership. They may consist of complex networks of wholly or partly owned subsidiaries, sub-subsidiaries and companies not linked by equity ownership but still closely related to or dependent on the business of an enterprise group (e.g. suppliers, distributors, franchisees).

Mevorach developed a comprehensive typology of multinational enterprise groups, depending on the degree of their integration/interdependence – to what extent the group operates as a single economic unity, and the level of control – how centralised or decentralised control and decision-making is.[69] In terms of integration, a distinction is made between business integration, asset integration and no integration. As for patterns of control, group entities may be centrally controlled from a single or multiple "heads" (centralised group),[70] enjoy certain autonomy but still be subject to direction or supervision by the parent company (decentralised group), or even lack a common head office (heterarchical group).

---

67 Mevorach points out that "narrowing the meaning of the term MEG *a priori* could be detrimental to a meaningful approach to [insolvencies within MEGs]." See I. Mevorach, Insolvency within Multinational Enterprise Groups, OUP, 2009, p. 24.

68 For the discussion of different types of groups (e.g. "hierarchy type", comprising diversified business groups and pyramidal business groups vs. "network-type" business groups, wherein individual entities maintain autonomy regarding strategic and budgetary decisions), see A.M. Colpan and T. Hikino (eds), Business Groups in the West: Origins, Evolution, and Resilience, OUP, 2018.

69 I. Mevorach, Insolvency within Multinational Enterprise Groups, OUP, 2009, pp. 135-47.

70 A good example of a corporate group with multiple parent companies was Unilever. Since its formation in 1930, Unilever was owned through two separately listed companies, Unilever PLC (UK) and Unilever NV (NL). It was agreed that the two holding companies would seek to operate as a single company, both administratively and economically. This was made possible over the years by a number of agreements entered into between the entities (Foundation Agreements) and by special provisions in their articles of association. The NV and PLC had the same directors and applied the same accounting policies. R. Abma, De mislukte unificatie van Unilever, Maandblad voor Ondernemingsrecht, n. 1-2, 2019, pp. 40-48. In 2020, Unilever unified its group legal structure under a single parent company, Unilever PLC.

Some group enterprises are notable for running a single business. It is observed that a typical group "is a single business firm organized as a collection of legal entities."[71] The degree of integration can be determined by reference to a wide variety of factors, reflecting the economic structure of the group (e.g. centralised administration of resources and intensity of intra-group transactions, handling of personnel), management of marketing (e.g. common trademarks and logos) and public image.[72] Integrated groups may have a vertical hierarchical structure, where a parent company owns, controls and directs its subsidiaries.[73] Such pyramid-like groups are typical for some European jurisdictions, such as Germany and Italy.[74] They also prevail among large US banks.[75]

Other groups consist of relatively self-sustaining, loosely connected business units, which are responsible for separate product or industry lines and can survive on their own. Some banking groups have chosen a decentralised corporate structure, organised according to a business segment, geographical presence, or functions. A good example is HSBC, the largest UK bank. It is composed of separate Operating Banks active in different geographical markets. Notably, the critical shared infrastructure, services and systems are moved into a bankruptcy-remote group of separately capitalised non-bank service companies. This division is made to reduce operational dependencies across critical functions, jurisdictions and legal entities.

The separability embedded within the structure of HSBC Group corresponds to the chosen resolution strategy, the multiple point of entry (MPOE) model, that entails "resolution of regional or national groups of affiliated companies",[76] as opposed to a resolution at a holding company level. This demonstrates how a regulatory (resolution) model affects the way a banking group is internally organised, and the other way round.

---

71 H. Hansmann and R. Squire, External and Internal Asset Partitioning: Corporations and Their Subsidiaries, in J.N. Gordon, W-G. Ringe (eds), The Oxford Handbook of Corporate Law and Governance, OUP, 2018, p. 262.

72 UNCITRAL Legislative Guide, Part three, Ch. I, para. 15.

73 Note that business integration and control patterns within a group do not always correlate in a specific way. Thus, centralised control does not necessarily lead to high business integration.

74 K.J. Hopt, Groups of companies: A Comparative Study of the Economics, Law, and Regulation of Corporate Groups, in J.N. Gordon, W-G. Ringe (eds), The Oxford Handbook of Corporate Law and Governance, OUP, 2018, p. 604.

75 J.N. Gordon, W-G. Ringe, Bank Resolution in the European Banking Union: A Transatlantic Perspective on What it Would Take, Columbia Law Review, Vol. 115, 2015, pp.1297-1370.

76 HSBC Holdings plc, SIFI Plan, Public Section, 17 December 2021, p. 2, noting that HSBC considered switching to a single point of entry (SPOE) model, but concluded that the MPOE is a preferred model, because it is "consistent with the decentralized financial, operational and legal entity structure of the HSBC Group."

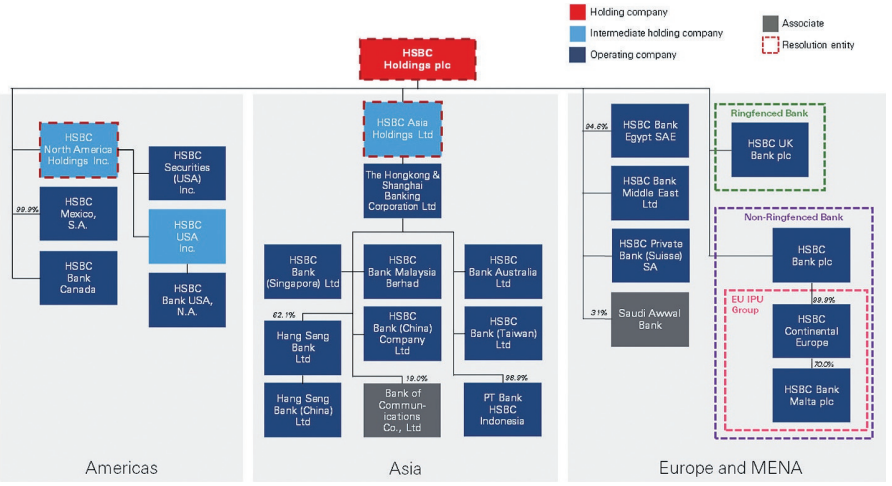

Figure 2. Simplified HSBC Group structure (as of 1 August 2023)[77]

While HSBC Group manifests a substantial degree of decentralisation, when it comes to global strategy, it is still centrally directed. Other enterprise groups may lack centralised control and hierarchical patterns and operate in a more heterarchical way, distinguished by decentralised and flatter corporate networks with largely autonomous profit centres.[78]

The diversity of corporate forms and structures complicates or makes impossible the adoption of a one-size-fits-all approach to their regulation, including regulation in a situation of financial distress and insolvency. At the same time, it is important to emphasise that closely integrated groups – groups consisting of separate legal entities but operating as a single economic unit – deserve special attention in insolvency. The reason is, first, that the interest of group members may differentiate them from any legal entity that operates "on its own" in any market. Second, and consequently, in such groups, a failure of one group member may be triggered by financial distress of other group members, while value can be preserved and maximised when a group is being taken into account (see section 1.1.2., describing the global sale of Nortel's assets). Another reason for paying special attention to

77 This figure is taken from the website of HSBC Group <https://www.hsbc.com/investors/investing-in-hsbc/group-structure> (accessed 1 August 2023). It does not include service companies and special purpose entities.

78 P. Muchlinski, Multinational Enterprises and the Law, 3d edn, OUP, 2021, p. 62, arguing that we may witness the "gradual replacement of closely held subsidiaries with free-standing companies linked to the parent by contract."

integrated groups is that the gradually appearing group-mindful insolvency law is particularly relevant to them.[79]

2.5 Enterprise Groups and the Curious Case of Limited Liability

There are multiple financial, economic, operational, fiscal and other reasons for enterprises to operate through the establishment of separate legal entities. Underpinned by the principles of entity shielding and limited liability, the separation of a single enterprise into distinct legal entities can decrease exposure to risks arising from failures related to a particular geographical market (e.g. when a group is planning to enter a new untested market) or a business segment (e.g. when a certain activity can lead to significant environmental liability or is simply riskier).[80] Thus, entity separation within groups can pursue a "protective" or risk-reduction function.

The protective function is closely related to another function that could be referred to as the "enabling" function. A layered corporate structure may enable the maximisation of financial returns. For example, a group can establish special entities responsible for raising funds on capital markets (SPVs), which can give access to foreign investors and secure better financing terms (see section 1.1.3. for Oi Brazil). The use of a group structure can also be driven by reasons of regulatory partitioning, defined as a "separation between the legal spheres of the corporation and its members beyond the attribution of property rights over assets."[81] Regulatory partitioning might be underpinned by fiscal considerations (tax allowances, tax exemp-

79 EIR Recast, Articles 56(1), 57(1) and 58, mandating cooperation between IPs and courts in a group insolvency, but only "to the extent that such cooperation is appropriate to facilitate the effective administration of those proceedings." G. Moss, I. Fletcher, S. Isaacs (eds), Moss, Fletcher and Isaacs on the EU Regulation on Insolvency Proceedings, 3rd edn, OUP, 2016, para. 8.756, noting that "[i]n order to obtain full value of the sale of assets which span different legal entities, a co-operative approach is likely to be essential." See also the Singapore's Insolvency, Restructuring and Dissolution Act 2018 (IRDA), section 65(2), permitting the court to restrain commencement or continuation of any proceedings or enforcement actions against a related company (subsidiary or holding company), but only if such related company plays a "necessary and integral role" in debtor's restructuring. See *Re IM Skaugen SE and other matters* [2019] 3 SLR 979; [2018] SGHC 259, at [63].

80 English courts accept that corporate risk compartmentalisation constitutes a legitimate use of the group structure. See *Adams v. Cape Industries plc* [1990] Ch 433. This, however, does not insulate the parent company from liability for actions of a subsidiary on the principles of tort law. See *Lungowe v. Vedanta Resources plc* [2019] UKSC 20. On the advantages of group structures, see also K.J. Hopt and K. Pistor, Company Groups in Transition Economies: A Case for Regulatory Intervention? European Business Law Review, Vol. 2, 2001, p. 13.

81 M. Pargendler, Regulatory partitioning as a key function of corporate personality, in E. Pollman and R.B. Thompson (eds), Research Handbook on Corporate Purpose and Personhood, Edward Elgar Publishing, 2021, p. 264.

tions for intra-group dividends, group relief).[82] It could also be mandated by specific regulatory requirements, like those applicable to financial institutions.[83] Another example of the regulation that prompts the creation of group structures and intra-group financial arrangements is Article 3:2 of the Dutch Act on Financial Supervision (*Wet op het financieel toezicht* or Wft). Under this article, no banking license is required for a group finance company if, among other requirements, such finance company on-lends or invests at least 95% of its balance sheet total within its group, and its liabilities arising from bond issuance are unconditionally guaranteed or otherwise secured by the parent company.[84] This is one of the reasons why in the Lehman Brothers and Oi Brazil cases, bonds issued by Dutch SPVs were guaranteed by parent companies.

Complex group structures have also developed naturally as a result of acquisitions and joint ventures. Corporate expansions are often facilitated by the quest for monopoly gains, the search for synergies, strategies to neutralise potential competitors, and the pursuit of economies of size and scale.[85] In recent years, a prominent trend in the business world has been the surge in takeovers motivated by the pursuit of new technologies and expanded customer bases. This strategy has resulted in several high-profile tech acquisitions, including Microsoft's acquisitions of Skype (2011), LinkedIn (2016) and GitHub (2018), Google's acquisitions of YouTube (2006), Motorola (2012) and Fitbit (2021), and Facebook's acquisitions of Instagram (2012) and WhatsApp (2014).

---

82 UNCITRAL Legislative Guide, Part three, Ch. I, para. 23; A.A. Berle Jr., The Theory of Enterprise Entity, Columbia Law Review, Vol. 47, 1947, p. 343; M. Sáez Lacave and M. Gutiérrez Urtiaga, Corporate Groups: Corporate Law, Private Contracting and Equal Ownership, ECGI Law Working Paper No 581, 2021, p. 8, noting that the "first reason why groups are valuable is that they offer the possibility to engage in regulatory arbitrage" and arguing that "[r]egulatory arbitrage can explain why many group structures are so complex and legally intractable."

83 For instance, the UK's banking sector structural reform of 2019 mandated that core banking services (e.g. taking deposits, making payments and providing overdrafts for UK retail customers and small businesses) was made financially, operationally and organisationally separate from investment banking and international banking activities. Therefore, retail and investment banking should be provided by separate legal entities. For discussion and criticism of this strategy, see T. Wetzer, In Two Minds: The Governance of Ring-Fenced Banks, Journal of Corporate Law Studies, Vol. 19, 2019, pp. 197-249. In response to the GFC, the USA introduced the Volcker rule (§ 619 of the Dodd-Frank Act). It imposes the group-level restrictions on banks and prohibits groups which include FDIC-insured banks from engaging in proprietary trading. The Volcker rule is of structural nature and affects the internal structure of banking groups. See J.C. Coates IV, The Volcker Rule as structural law: implications for cost-benefit analysis and administrative law, Capital Markets Law Journal, Vol. 10, 2015, pp. 447-468.

84 W.A.K. Rank and W. van Spanje, Dutch Lehman jitters? Butterworths Journal of International Banking and Financial Law, February 2009, pp. 89-92.

85 O.E. Williamson, The Modern Corporation: Origins, Evolution, Attributes, Journal of Economic Literature, Vol. 19, 1981, pp. 1537-1568.

Whether as a result of natural growth and expansion or in pursuit of a deliberate attempt to insulate risk and acquire additional regulatory benefits, modern enterprises predominantly exist as groups of companies. However, their existence would likely not have been possible or would have been materially curtailed without limited liability and entity shielding – two fundamental doctrines in company law.[86] "Limited liability" protects shareholders from the liability for debts incurred by legal entities they create or invest in, while "entity shielding" ensures that creditors of shareholders cannot have a direct recourse against the assets of their companies.

For many decades, the doctrine of limited liability has been widely praised. In the often-cited 1911 speech, the President of Columbia University and a future Nobel Peace Prize recipient, Nicholas Murray Butler, declared: "I weigh my words, when I say that in my judgment the limited liability corporation is the greatest single discovery of modern times […]. Even steam and electricity are far less important than the limited liability corporation, and they would be reduced to comparative impotence without it."[87] In 1926, The Economist proclaimed: "The economic historian of the future may assign to the nameless inventor of the principle of limited liability, as applied to trading corporations, a place of honour with Watt and Stephenson, and other pioneers of the Industrial Revolution."[88] Nearly a century later, Andenas and Wooldridge noted that "limited liability […] has become a force driving the organization of large multi-company enterprises."[89]

As noted above, limited liability does not constitute a necessary or indispensable characteristic of a legal entity or its economic prosperity. Indeed, history shows that the invention of limited liability and its entrenchment

86 Hansmann and Kraakman refer to these doctrines as "defensive asset partitioning" (protecting personal assets of shareholders from the company's creditors) and "affirmative asset partitioning" (shielding the company's assets from the creditors of its shareholders and managers). See H. Hansmann and R. Kraakman, The Essential Role of Organizational Law, The Yale Law Review, Vol. 110, 2000, pp. 387-440.

87 N.M. Butler, Politics and Economics, 143rd Annual Banquet of the Chamber of Commerce of the State of New York, 1911. The President of Harvard University, Charles W. Eliot, shared a similar view, pointing out that the "principle of limited liability is by far the most effective legal invention for business purposes made in the nineteenth century." Quoted in W. Cook, Watered Stock Commissions Blue Sky Laws Stock without Par Value, Michigan Law Review, Vol. 19, 1921, p. 583.

88 The Economist, 18 December 1926, p. 1053. Note that the attitude to limited liability has not always been positive. The 1824 editorial from *The Times of London* shared the view that "[n]othing can be so unjust as for a few persons abounding in wealth to offer a portion of their excess for the information of a company, to play with that excess – to lend the importance of their whole name and credit to the society, and then should the funds prove insufficient to answer all demands, to retire into the security of their unhazarded fortune, and leave the bait to be devoured by the poor deceived fish."

89 M. Andenas and F. Wooldridge, European Comparative Company Law, CUP, 2009, p. 829.

did not coincide with the recognition of legal personhood. It is likely that early commercial enterprises did not possess the characteristic of limited liability. In many cases, the issue of shareholder liability did not arise at all, either due to an effective state guarantee, as in the case of the VOC, or due to the late arrival of insolvency statutes applicable to companies.[90] In light of this, a few questions arise. First, what is the rationale behind and the (economic) reasons for having limited liability? Second, how do these rationale and reasons stand or play out in a group context? We will address these questions below. In doing so, our goal is not to cover all the arguments that can be made to explain the emergence of limited liability as a default rule. Instead, the focus is on the leading theories of limited liability.

One of the first attempts to theoretically substantiate limited liability was made by Manne, who wrote that "[l]imited liability is probably an essential aspect of a large corporate system with widespread public participation."[91] This argument is predicated on the assumption that unlimited liability would deter small investors from participating in large enterprises, such as railroads, canals, or long-distance sea voyages. Hundreds or even thousands of dispersed shareholders in a public company may have relatively limited economic incentives and high costs involved in monitoring or managing such an enterprise. This is why, the argument goes, a shift in the risk of failure from shareholders to creditors is defendable.[92] While this argument is appealing in a situation of widespread distribution of shares, it becomes less convincing for groups in which a parent entity exercises control and oversight over its subsidiaries. The desire to encourage investment by many small shareholders (i.e. absentee investors) who have no real decision-making power, does not easily apply to the establishment of a multi-layered group structure. Mevorach asserts (and we agree) that "[e]ncouragement of entrepreneurial risk-taking […] is less relevant when considering a group which conducts a common business."[93] It remains a mystery how and why limited liability, originally designed to encourage capital investments by many individuals, was extended to a parent-subsidiary relationship.

90 R. Harris, A new understanding of the history of limited liability: an invitation for theoretical reframing, Journal of Institutional Economics, Vol. 16, 2020, pp. 643-664; P. Wood, Corporate, Bank and Sovereign Insolvencies: Why the Difference? Business Law International, Vol. 22, 2021, p. 315, noting that "[h]istorically, the seeds of corporate bankruptcies germinated out of the bankruptcy of individuals, an area of law stretching back to the far past."

91 H.G. Manne, Our Two Corporation Systems: Law and Economics, Virginia Law Review, Vol. 53, 1967, p. 262.

92 One may wonder, however, whether this risk shifting is justified with respect to involuntary creditors, such as tort victims.

93 I. Mevorach, Insolvency within Multinational Enterprise Groups, OUP, 2009, pp. 42-43.

Reflecting on this, Blumberg writes that "[l]imited liability for corporate groups, one of the most important legal rules in modern economic society, appears to have emerged as a historic accident."[94]

Another benefit frequently assigned to limited liability relates to the efficient operation of stock markets. Halpern, Trebilcock and Turnbull argue that in the absence of limited liability, share prices will depend on the relative wealth of equity holders. This is because under the unlimited liability regime, an expected rate of return and level of risk for both creditors and shareholders correlate with the wealth level of each shareholder, or the ratio of such wealth to the maximum potential loss in the event of default.[95] As a result, the price of shares in the same company would be affected by the relative wealth of a buyer or seller of shares, ultimately having a constraining effect on their tradability. There are two problems with this statement. First, it fails to explain the early operation of capital markets with tradable shares but without limited liability. Second, it is based on the assumption that limited liability fully insulates the company from its shareholders. In the economic reality of corporate groups, this assumption loses its salience, as the share price or the price of debt securities issued by a group member often reflects the overall economic strength of the entire group. This becomes evident in situations where one or more group entities provide guarantees, or where the debtor is closely integrated with or reliant on the well-being of other group entities.[96] Therefore, the identity of a shareholder or shareholders preserves its relevance.

---

94 P. Blumberg, Limited Liability and Corporate Groups, The Journal of Corporation Law, Vol. 11, 1986, p. 605.

95 P. Halpern, M. Trebilcock, S. Turnbull, An Economic Analysis of Limited Liability in Corporation Law, University of Toronto Law Journal, Vol. 30, 1980, p. 130. The advantages of limited liability were summarised by Easterbrook and Fischel, who summed up that limited liability: reduces the costs of monitoring managers and other shareholders ("[l]imited liability makes the identity of other shareholders irrelevant"); promotes free transfer of shares; makes shares homogeneous commodities; allows more efficient diversification ("[d]iversification would increase rather than reduce risk under a rule of unlimited liability"); facilitates optimal investment decisions. See F.H. Easterbrook, D.R. Fischel, Limited Liability and the Corporation, University of Chicago Law Review, Vol. 52, 1985, pp. 89-117.

96 *In re Oi Brasil Holdings Coöperatief U.A.*, 578 B.R. 169, 180 (Bankr. S.D.N.Y. 2017), quoting the offering memorandum for the 2021 Notes, issued by Coop: "the ability of [Coop] to pay principal, interest and other amounts due on the Notes and other indebtedness will depend upon the financial condition and results of operations of Oi and its subsidiaries that are creditors of [Coop]." Financial position of group entities was also taken into account in *DTEK Energy BV, Re* [2021] EWHC 1551 (Ch), at 19, citing among other factors, evidence that if "the schemes are not implemented it is "highly likely" that disordered "domino" insolvencies would occur across the Group." INSOL International Special Report, Restructuring Cross-border Groups: Key Considerations Around Foreign Tax and Finance-driven SPVs, June 2020, para. 2.3., noting that in a going concern situation "[c]reditors [...] typically look at the group as a whole and do not focus particularly on the SPV that issued the debt instruments."

More than forty years ago, Posner suggested that the division of an enterprise into a bundle of formally separate but commonly owned and controlled entities should simplify risk assessment for creditors (i.e. evaluation of a borrower's creditworthiness) and thus reduce monitoring costs and bring down the cost of credit.[97] According to Posner, corporate division and limited liability aim to solve the problems of information and supervision. Instead of appraising the enterprise in its entirety, creditors only need to look into the existing and expected assets and liabilities of a separate legal entity, which should arguably be cheaper. Paraphrasing the English poet John Donne, each group company is perceived to be "an island entire of itself." However, in practice, a clear-cut division of an enterprise into isolated islands of assets and liabilities does not occur and is therefore unrealistic.[98] In fact, in many groups, the internal organisation and partition are rather complex or even messy. Therefore, the monitoring costs for creditors are not necessarily reduced, and the informational efficiency attributed to limited liability may be overstated. As will be demonstrated later in the book, various group liability arrangements exacerbate the problem by contractually perforating limited liability and building bridges – serving as the channels for interdependence and contagion – between group "islands".

The principle of limited liability and the related principle of entity shielding are deeply ingrained in legal traditions, even though the degree of their assertion may vary from one jurisdiction to another[99] and from one area of law to another.[100] It is not our purpose to question the many benefits of limited liability, particularly for public companies with distributed shareholding[101] and for highly diversified or heterarchical groups, in which

97 R.A. Posner, The Rights of Creditors of Affiliated Corporations, University of Chicago Law Review, Vol. 43, 1975, pp. 499-526.

98 K. Ayotte, H. Hansmann, Legal Entities as Transferable Bundles of Contracts, Michigan Law Review, Vol. 111, 2013, p. 722, noting that the "ambiguity of entity boundaries, therefore, may in fact raise creditor-monitoring costs in large corporate groups, not lower them."

99 See with respect to Brazil, M. Pargendler, How Universal Is the Corporate Form? Reflections on the Dwindling of Corporate Attributes in Brazil, Columbia Journal of Transnational Law, Vol. 58, 2019, p. 4, pointing out that "Brazilian law has eroded the most fundamental elements of the corporate form – namely, "capital lock-in" (or "entity shielding") and limited liability – with the effect that there is no longer a strong separation between the assets of Brazilian business corporations and their shareholders." On the other side of the spectrum is the UK, where, since the House of Lords' decision in *Salomon v. A Salomon and Co Ltd* [1897] AC 22 (dealing with a one-man company!), the "principle of separate personality and the privilege of limited liability enjoy great force in English common law." C. Gerner-Beuerle and M. Schillig, Comparative Company Law, OUP, 2019, p. 975.

100 K.E. Sørensen, Groups of Companies in the Case Law of the Court of Justice of the European Union, European Business Law Review, Vol. 27, 2016, pp. 393-420.

101 S.M. Bainbridge and M.T. Henderson, Limited Liability: A Legal and Economic Analysis, Edward Elgar Publishing, 2016, p. 10, noting that "the idea of limiting liability of shareholders in large public companies, especially when those shareholders are individuals with modest means, is fairly uncontroversial."

business and risk compartmentalisation develops naturally. But it is worth pointing out that for those groups operating an integrated business with intra-group liability arrangements, the rationale for limited liability is weaker.[102] Given that distinguishing the two situations is not easy, the policy of limited liability applies by default. Yet the strength of this policy and the policy of preserving separateness of assets and liabilities of group entities (asset partitioning) should not prevent legal responses that recognise the group reality without contravening these policies. Entity separateness does not mean entity insulation in law.

2.6 Conclusion

This chapter introduces the phenomenon of enterprise groups. It shows that corporate groups had a relatively late arrival on the historical stage. This arrival post-dated the recognition and conceptualisation of the legal personhood attribute, or of a legal personality separate from its members. It also came after the idea of limited liability was crystallised and established in law, although not everywhere at the same time. The rapid rise of hierarchical groups coincided with the fast-paced industrial progress of the late 19th and beginning of the 20th century and the liberalisation of corporate laws in the UK and the USA. This liberalisation gave a green light to intercorporate stockholding – a prerequisite for the emergence of a parent-subsidiary structure. Over the 20th century, enterprise groups grew in size and complexity and became one of the prevalent forms for organising business.

Following a brief historical overview, the chapter observes that despite the current dominance of a corporate group structure, legal definitions of a group vary between jurisdictions and also between different contexts and regulatory domains (e.g. tax, accounting, prudential regulation, company, insolvency). Frequently, a group of companies is defined with reference to control and influence, exercised by one legal entity over another. This control may be presumed if a certain percentage of capital or votes is reached. Instead of being caught up in definitional debates and taking into account that insolvency law benefits from an inclusive definition of a group, we focus on some characteristic elements and types of groups.

Enterprise groups can be distinguished based on two factors: the extent of business integration and intra-group interdependence, and the level of control and decision-making independence within the group. Historically, groups have often taken the form of integrated pyramid-shaped enterprises.

102 H. Hansmann and R. Squire, External and Internal Asset Partitioning: Corporations and Their Subsidiaries in J.N. Gordon, W-G. Ringe (eds), The Oxford Handbook of Corporate Law and Governance, OUP, 2018, p. 252, arguing that "a corporate group's use of intra-group guarantees weighs in favor of disregarding the group's internal partitions."

However, looking ahead, we may see more decentralised group structures, in part facilitated by technological advancements and a general shift to the service and information-based economy.

Finally, the chapter discusses fundamental doctrines underpinning the existence of corporate groups today – limited liability and entity shielding. These doctrines pre-determine a separate entity treatment in company and insolvency law. It is emphasised that limited liability, called by some as the "greatest single discovery of modern times", was initially sought to safeguard the position of many small individuals investing in large enterprises like railroads and canals, but was later replicated in a group setting. This raises many questions about the (economic) rationale and benefits of limited liability for groups of companies which engage in a single business and voluntarily perforate limited liability with the help of different cross-entity liability arrangements (cross-guarantees, co-debtorship). While sharing some thoughts on this, we do not explore all possible arguments in favour or against limited liability and the corresponding principle of entity shielding. Instead, it is argued that the centrality of the doctrine of limited liability does not have to stifle the development and application of legal tools that aim to reflect the economic reality of enterprise groups without breaching entity (asset) separateness.

3 Enterprise Groups and Insolvency Law▪

3.1 Introduction

Thomas H. Jackson, the author of the well-known creditors' bargain theory, recently wrote that "[o]ne need not reinvent the wheel to recognize that bankruptcy will always be a "work in progress (a good thing for bankruptcy scholars!)."[1] Another expert in insolvency and financial law, Philip Wood, noted that "[e]verything in insolvency law is controversial."[2] These insightful remarks reflect the state of affairs in the area of enterprise group insolvency law, which has seen significant developments over the course of the last few decades.

The outbreak of COVID-19 and the subsequent drastic governmental measures to curb the spread of the virus had a profound impact on businesses of all sizes. Multinational companies that heavily rely on global supply chains, uninterrupted liquidity flows, and free travel, such as airlines and car rentals, were particularly affected. LATAM Airlines Group, Norwegian Air and Hertz,[3] the early victims of the pandemic, filed for insolvency or

---

▪ This chapter builds upon the following previously published work by the author:
- I. Kokorin and B. Wessels, Cross-Border Protocols in Insolvencies of Multinational Enterprise Groups, Edward Elgar Publishing, 2021.
- I. Kokorin, The Rise of "Group Solution" in Insolvency Law and Bank Resolution, European Business Organization Law Review, Vol. 22, 2021, pp. 781-811.
- I. Kokorin, Conflicts of interest, intra-group financing and procedural coordination of group insolvencies, International Insolvency Review, Vol. 29, 2020, pp. 32-60.
- I. Kokorin, Contracting Around Insolvency Jurisdiction: Private Ordering in European Insolvency Jurisdiction Rules and Practices, in V. Lazić and S. Stuij (eds.), Recasting the Insolvency Regulation: Improvements and Missed Opportunities. Short Studies in Private International Law, Den Haag: Asser Press, 2020, pp. 21-57.
- I. Kokorin, Co-ordination in bank resolution and the issue of conflicts of interest, Journal of International Banking Law and Regulation, Vol, 35, 2020, pp. 100-115.
- B. Wessels and I. Kokorin, European Union Regulation on Insolvency Proceedings: An Introductory Analysis, Alexandria: American Bankruptcy Institute, 2018.

1 T.H. Jackson, Bankruptcy's logic and limits in the 21st century: some thoughts on Chapter 11's evolution and future, in B.E. Adler (ed), Research Handbook on Corporate Bankruptcy Law, Edward Elgar Publishing, 2020, p. 7.

2 P. Wood, Corporate, Bank and Sovereign Insolvencies: Why the Difference? Business Law International, Vol. 22, 2021, p. 307.

3 For the analysis of Hertz's bankruptcy, see J.A.E. Pottow, Love *Hertz*: Corporate Groups and Insolvency Forum Selection, Texas International Law Journal, Vol. 56, 2021, pp. 155-180.

restructuring – the process in which several jurisdictions and courts were engaged. The ongoing economic recession has been accompanied by a surge in global debt. According to the Institute of International Finance, the total global debt reached USD 296tn by the end of the second quarter of 2021, up from USD 270.9tn a year earlier. This debt includes USD 86tn in government borrowing, USD 86tn in non-financial corporate borrowing, USD 69tn in the financial sector, and USD 55tn in household borrowing.[4] With the eventual termination of state support, along with soaring inflation rates and gas prices, it is possible that the number of insolvencies may increase.[5]

This chapter discusses the application of insolvency law to groups of companies. Section 3.2. outlines different approaches to group insolvencies, noting that insolvency law is traditionally entity-focused (entity bias). This results in an entity-by-entity treatment of group companies in financial distress, with a focus on post-crisis liquidation of debtor's assets and allocation of sale proceeds among creditors of each legal entity. However, the situation could be changing with the emergence of laws that increasingly acknowledge the unique features of groups, premised on operational and financial links and interdependencies between group companies forming a single enterprise.

Section 3.3. introduces three restructuring procedures which occupy a prominent place in the restructuring law toolbox of the selected jurisdictions. These procedures are UK schemes of arrangement, US Chapter 11 reorganisations and Dutch WHOA schemes. They are widely used in practice and are often relied on to effectuate financial and/or operational restructuring of business enterprises, including groups of companies. As these procedures will be frequently referenced in the subsequent chapters, it is important to provide their general overview early in the book.

The gradual shift from a single entity approach to a single enterprise approach is addressed in section 3.4. We first hypothesise why the recognition of groups in insolvency law has been lagging behind the emergence of corporate groups as major economic players in national and global economies (section 3.4.1). Sections 3.4.2. and 3.4.3. explore potential reasons or triggers for the adoption of instruments targeting enterprise group insolvency. Section 3.5. aims to identify the limits of a single enterprise approach in both the resolution of credit institutions (section 3.5.1.) and in corporate

4 G. Tett, Global debt is soaring – and we need to talk about it, Financial Times, 16 September 2021.

5 UK Office for National Statistics, Rising business insolvencies and high energy prices, 7 October 2022, observing that corporate insolvencies in England and Wales in the second quarter of 2022 reached their highest quarterly level since Quarter 3 (July to September) 2009. More than 1 in 10 UK businesses reported a moderate-to-severe risk of insolvency in August 2022.

insolvency law (section 3.5.2.). We observe that the enterprise approach need not interfere with the core of entity separateness, preserving the value of limited liability and entity shielding. Section 3.6. concludes.

3.2 Three Generations of Insolvency Law

The evolution of (international) insolvency law, with a specific focus on group insolvencies, can be categorised into distinct stages or generations.

The first generation (until the mid-1990s) – "insolvency law 1.0." – exhibits the lack of rules for dealing with failing enterprise groups, as well as for handling cross-border insolvencies more generally. In the absence of a special legal framework, territorialist inclinations often prevailed,[6] resulting in fragmented country-by-country responses to group distress. This is not to say that there were no examples of successful administration of group cases. In practice, pragmatic solutions emerged as commercially minded IPs and courts intuitively sought to navigate the challenges posed by the underdeveloped international insolvency law. One notable solution that arose was the adoption of cross-border insolvency protocols. Early examples of these protocols were negotiated and adopted to address the failures of multinational enterprise groups, such as Maxwell Communication, Olympia and York, and Commodore.[7] These protocols sought to promote cooperation between courts and IPs in different jurisdictions, to coordinate the administration of parallel insolvency proceedings, reduce associated costs, and avoid the duplication of effort and irreconcilable judgments.

The second generation (from the mid-1990s until the mid/late 2010s) – "insolvency law 2.0." – coincides with the appearance of hard and soft law instruments that target international aspects of insolvency proceedings. These instruments include, inter alia, the UNCITRAL Model Law on Cross-Border Insolvency (MLCBI),[8] the Directive on the reorganisation and winding up of credit institutions (Winding Up Directive or CIWUD),[9] and the original EU Regulation on insolvency proceedings (EIR 2000).[10]

6 I. Mevorach, The Future of Cross-Border Insolvency: Overcoming Biases and Closing Gaps, OUP, 2018, Chapter 2, discussing how territorialist inclinations and tendencies may be driven by different cognitive biases, including loss aversion, status quo bias, endowment effect and short termism. The debate between universalism and territorialism is well known in literature. For integrated enterprise groups, coordinated responses and centralisation promoted by universalism or modified universalism is beneficial.

7 On cross-border protocols used in group insolvency scenarios, see I. Kokorin, B. Wessels, Cross-Border Protocols in Insolvencies of Multinational Enterprise Groups, Edward Elgar Publishing, 2021.

8 UNCITRAL Model Law on Cross-Border Insolvency (1997).

9 Directive 2001/24/EC of the European Parliament and of the Council of 4 April 2001 on the reorganisation and winding up of credit institutions.

10 Council Regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings.

The MLCBI addresses matters such as access to foreign courts, recognition of and relief to foreign insolvency proceedings, and cooperation in cross-border cases. It is an instrument of soft law, meaning that it requires transposition into national law to be legally binding. Once implemented, it becomes a part of the domestic legal framework.[11] As of June 2023, legislation based on or influenced by the MLCBI has been adopted in 58 states in a total of 61 jurisdictions, including the USA, the UK, Brazil, Singapore, Japan, Australia, Canada, Mexico and Israel.[12] Several other countries are considering adopting the MLCBI (the Netherlands, India) or have laid down the rules which are similar to or are strongly inspired by the MLCBI, including Spain, Germany and Belgium.[13] The CIWUD and the EIR 2000 are instruments of mandatory EU law, addressing enterprise failures, but differing in their personal scope. The CIWUD applies to credit institutions,[14] while the EIR 2000 (before being replaced by the EIR Recast) covered natural persons and non-financial entities.[15] These EU law instruments establish uniform rules on, inter alia, international jurisdiction, recognition and applicable law in insolvency matters.

The notable feature of the second generation of insolvency law instruments is that they target a single-debtor insolvency. The MLCBI, the CIWUD and the EIR 2000 do not have provisions designed for enterprise group insolvency. The explanation offered by the UNCITRAL Working Group V, responsible for drafting the text of the MLCBI, is quite revealing. It stated that "[w]hen the text of what became the UNCITRAL Model Law on Cross-Border Insolvency (Model Law) was debated, groups were regarded as "a stage too far".[16] This also explains the absence of group-oriented insolvency rules at the EU level at that time.[17] Nevertheless, the emergence of instru-

11 Noting this transformational aspect of soft law, Pottow uses the terms "semi-soft law" or "contingently soft law." He also points out the dialogue-provoking role of soft law and its influence on the evolving international norms. See J.A.E. Pottow, The Dialogic Aspect of Soft Law in International Insolvency: Discord, Digression, and Development, Michigan Journal of International Law, Vol. 40, 2019, p. 481.

12 Status: MLCBI <https://uncitral.un.org/en/texts/insolvency/modellaw/cross-border_insolvency/status> (accessed 15 July 2023).

13 S. Madaus, A.K. Wilke and P. Knauth, Bringing Non-EU Insolvencies to Germany: Really so Different from the UNCITRAL Model Law on Cross-Border Insolvency? International Corporate Rescue, Vol. 17, 2020, pp. 21-28.

14 CIWUD, Article 1.

15 EIR 2000, Article 1(2). The EIR 2000 was repealed with the entry into force of the EIR Recast on 26 June 2017.

16 UNCITRAL Working Group V, Thirty-eighth session, UNCITRAL Legislative Guide on Insolvency Law, Part three: Treatment of enterprise groups in insolvency, 11 February 2010, p 3.

17 M. Virgós and E. Schmit, Report on the Convention on Insolvency Proceedings, 1996, para. 76, making it clear that the European Convention 1995, the never-adopted predecessor of the EIR 2000, "offers no rules for groups of affiliated companies (parent-subsidiary schemes)."

ments for cross-border insolvency, even if for single debtors, represented significant progress that had a spill-over effect on group insolvencies. The EIR 2000 and the MLCBI were instrumental in resolving complex insolvencies involving groups of companies.[18] They were used to achieve centralisation of proceedings concerning group entities in a single jurisdiction and to ensure cross-border recognition of group-wide solutions.[19]

The third generation (from the mid/late 2010s) – "insolvency law 3.0." – is distinguished by the legal texts which accept the need to adjust insolvency law approaches to the characteristics and business reality of groups of companies. Recent years have witnessed the emergence of initiatives and new legal instruments that modernise insolvency law to ensure the effective and efficient administration of insolvency within enterprise groups. This occurred at the national, regional and international (including soft law) levels.

At the national level, group insolvency is addressed in some EU Member States. For example, Germany reformed its law in 2017 to facilitate efficient administration of group insolvency proceedings through enhanced coordination. This is achieved by means of concentration of insolvency proceedings in one court, appointment of the same IP in separate proceedings and opening of special group coordination proceedings (*Koordinationsverfahren*).[20] Group-focused insolvency rules have lately been

18 I. Mevorach, On the Road to Universalism: A Comparative and Empirical Study of UNCITRAL Model Law on Cross-Border Insolvency, EBOR, Vol. 12, 2011, pp. 517-557.

19 I. Mevorach, The Future of Cross-Border Insolvency: Overcoming Biases and Closing Gaps, OUP, 2018, p. 227, emphasising that "[p]ractice demonstrates that often the professionals and courts implementing the MLCBI or the EIR could achieve [group] solutions through a 'pragmatic' approach, paving the way for the emergence of the modified universalist norm concerning groups by applying the jurisdiction and recognition rules expansively to accommodate these more complex structures." This is evidenced in the group-sensitive understanding of COMI, as demonstrated by some courts. See *Re: Zetta Jet Pte Ltd and others* [2019] SGHC 53, holding that "in ascertaining a specific company's COMI, there is no need to maintain strictly the distinction between different entities within a group. It is possible for the analysis to be made of the activities of an entire group of companies, rather than of the specific debtor company in question."

20 *Gesetz zur Erleichterung der Bewältigung von Konzerninsolvenzen* (KonInsoErlG) (Law for the facilitation of the handling of group insolvencies), 13.04.2017, Bundesgesetzblatt Jahrgang 2017 Teil I Nr. 22, ausgegeben am 21.04.2017, p 866. On this law, see J. Schmidt, Corporate groups, in P.J. Omar and J.L.L. Gant (eds), Research Handbook on Corporate Restructuring, Edward Elgar Publishing, 2021, pp. 214-227.

enacted in Italy,[21] Spain[22] and France.[23] For the most part, they concentrate on procedural aspects, such as jurisdiction, appointment of a single IP and communication between courts and IPs. A wave of restructuring-related reforms in the EU has led to the emergence of group-mindful substantive rules. For example, both the Dutch WHOA and the German StaRUG[24] introduced important innovations like third-party releases.

Insolvency of groups has also attracted attention of policymakers outside Europe. In 2019, the Insolvency and Bankruptcy Board of India created a Working Group on Group Insolvency to discuss and draft a possible group insolvency framework.[25] In Argentina, the insolvency law focuses on group reorganisations and provides for the possibility of a single or joint application to embrace all group members.[26] This happens in cases where the insolvency of one group member may affect other group members, or where companies within the group are closely integrated. Interestingly, Argentinian law permits the inclusion of solvent group members in an insolvency application, so long as it is in the interest of the entire group and facilitates a group reorganisation.[27] In Brazil, group insolvency cases often result in substantive consolidation, even without direct statutory authority for such

21 *Codice della crisi d'impresa e dell'insolvenza in attuazione della legge 19 ottobre 2017*, n. 155, Titolo VI. Disposizioni relative ai gruppi di imprese. D. Corapi and D. Benincasa, The Law on Groups of Companies in Italy, European Company Law, Vol. 16, 2019, pp. 121-129; A. Zorzi, The Italian Insolvency Law Reform, European Business Law Review, Vol. 32, 2021, pp. 935-964.

22 *Ley Concursal*, Artículo 25, allowing a debtor or a creditor to submit a petition for declaration of joint insolvency proceedings of several debtors if they are part of the same group of companies.

23 *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 Code de commerce. This article specifies the jurisdiction of specialised commercial courts over certain insolvency proceedings and provides that companies facing an insolvency proceeding with subsidiaries in a similar position are subject to the same court. See also Article L. 621-2 of Code de commerce, which allows the extension of insolvency proceedings to a related company in the event of confusion of its assets with that of the debtor or of fictitiousness of that legal person. See H. Bourbouloux, S. Hustaix, National Report on France, in B. Wessels and S. Madaus (eds), Rescue of Business in Europe. A European Law Institute Instrument, OUP, 2020, pp. 674-676.

24 Gesetz über den Stabilisierungs- und Restrukturierungsrahmen für Unternehmen (Unternehmensstabilisierungs- und -restrukturierungsgesetz - StaRUG) vom 22. Dezember 2020 (BGBl. I S. 3256), Enterprise Stabilization and Restructuring Act.

25 Report of the Working Group on Group Insolvency, 23 September 2019; Report of CBIRC-II on Group Insolvency, December 2021.

26 Argentina's Bankruptcy and Liquidation Law No. 24,552 (*Ley de Concursos y Quiebras*), Chapter VI, art. 65-68. See M.E. Uzal, National Report on Argentina, in R.M. Manóvil (ed), Groups of Companies: A Comparative Law Overview, Springer, 2020, pp. 614-616.

27 Ibid., p. 615.

consolidation. There, a lenient approach to procedural consolidation led to a silent acceptance of substantive consolidation as a norm.[28]

In EU law, in the area of insolvency and bank resolution, enterprise groups have, for the first time, been directly acknowledged in the BRRD (2014) and the EIR Recast (2015). They reflect the distinct characteristics of groups, provide a definition of a group of companies and offer or mandate special mechanisms and tools to respond to the challenges of enterprise group insolvencies (e.g. group coordination proceedings, group recovery and resolution plans, group financial support agreements).

At the global level, we should mention the MLEGI – a new model law published by UNCITRAL in 2019.[29] The MLEGI seeks "to provide effective mechanisms to address cases of insolvency affecting the members of an enterprise group."[30] Unlike the MLCBI, it is specifically designed for group insolvencies and aims to promote several objectives: making the administration of cross-border insolvencies of enterprise groups more efficient, ensuring the protection and maximisation of the insolvency estate value, facilitating rescue of financially troubled groups of companies and supporting the adoption of group insolvency solutions. While it remains to be seen whether the MLEGI will repeat the success of its predecessor,[31] it might face some opposition at the national level, perhaps due to concerns about corporate separateness and state control over local companies. Equally important is the observation that the enactment of hard law does not guarantee its effectiveness. Hard law does not necessarily mean widely used law. A good example is the EIR Recast's framework on group coordination. Since the EIR Recast became binding in 2017, not a single significant case of a cross-

28 For criticism of the Brazilian approach, see S.C. Neder Cerezetti, Reorganization of Corporate Groups in Brazil: Substantive Consolidation and the Limited Liability Tale, International Insolvency Review, Vol. 30, 2021, p. 182, noting that the current Brazilian cases of substantive consolidation treat "an exceptional measure as a day-to-day event, dramatically altering the rights of creditors and the obligations of debtors without regard to the limitation of liability."

29 Another instrument worth mentioning is the World Bank Principles for Effective Creditor Rights and Insolvency Regimes, 2011, which for the first time included new principles "to reflect best international practice in the regulation of the insolvency of enterprise groups."

30 MLEGI, Preamble.

31 As of June 2023, the MLEGI has not been transposed in national laws. In July 2022, the UK Insolvency Service launched a consultation on the implementation of MLEGI. In July 2023, the UK government announced its intention to implement the MLEGI at the earliest opportunity.

border group insolvency has been handled under the group coordination procedure.[32]

3.3 Three Restructuring Procedures

3.3.1 The UK: schemes of arrangement

A scheme of arrangement is a statutory procedure available under Part 26 (sec. 895-901) of the UK Companies Act 2006.[33] Section 895 of this law defines a scheme as a compromise or arrangement between a company and its creditors, or any class of them, or between a company and its members (shareholders). Companies use schemes for a wide variety of debt-reduction strategies affecting debt and/or equity. These strategies may include a debt-to-equity swap,[34] modification (e.g. extension of maturity dates[35]) or reduction (e.g. partial write-off) of creditors' claims.[36]

Schemes of arrangement have not always enjoyed the level of popularity they do today. Available under the UK Companies Act 1948, they were regarded as time-consuming, complex (requiring the involvement of experts and preparation of extensive documentation), costly and not particularly well-suited for companies on the verge of insolvency or insolvent companies.[37] However, since the 2000s, schemes have become a widely used mechanism for restructuring of financially distressed or insolvent companies. Several factors contribute to this revival and increasing popularity of schemes. It is clear now that schemes of arrangement are available to both solvent and insolvent debtors.[38] To the extent that a scheme of arrangement is open for non-insolvent debtors and is regulated by non-insolvency

32 CERIL Statement 2021-2 on EU Group Coordination Proceedings, 29 June 2021. See also C. Thole, M. Dueñas, Some Observations on the New Group Coordination Procedure of the Reformed European Insolvency Regulation, International Insolvency Review, Vol. 24, 2015, p. 214, noting that, whereas a coordination procedure is "a step into the right direction, the procedure has significant shortcomings such as the weak position of the coordinator, a liberal opt-in and opt-out mechanism and the problem of forum shopping."

33 For an overview of English schemes of arrangement, see J. Payne, Schemes of Arrangement: Theory, Structure and Operation, CUP, 2021.

34 *Re Uniq Plc* [2011] EWHC 749 (Ch); *Re Avanti Communications Group Plc* [2018] EWHC 653 (Ch).

35 *Re Apcoa Parking Holdings GmbH et al.* [2014] EWHC 3849 (Ch).

36 *Primacom Holdings GmbH* [2012] EWHC 164 (Ch).

37 P.J. Omar, J.L.L. Gant, Corporate Rescue in the United Kingdom: Past, Present and Future Reforms, Insolvency Law Journal, Vol. 24, 2016, pp. 40-61.

38 See *Scottish Lion Insurance Co Ltd v. Goodrich Corp* [2010] CSIH 6, 2010 SC 349, confirming that "[t]here is nothing in that statute nor in its descendents [...] to suggest that applications for sanction of a "solvent scheme" are in principle to be dealt with differently from those where the company is insolvent or on the verge of insolvency."

legislation (Companies Act 2006), it avoids insolvency-related stigma and usually does not trigger cross-default and forfeiture clauses in contracts.[39]

The flexibility of schemes of arrangement makes them suitable for achieving a wide range of purposes. In principle, schemes can be used for any compromise or arrangement between the debtor and its creditors, as long as there is some form of a "give and take" between them.[40] The procedure for entering a scheme consists of two stages. The first one involves a hearing on class composition and does not entail an assessment of the scheme on its fairness or merits.[41] The second one comprises a scheme meeting, where creditors vote on the proposed arrangement, and a court confirmation (sanctioning) hearing. At this hearing, the court must be satisfied, inter alia, that the scheme is fair. In this context, fairness has a specific and rather narrow meaning. The court simply has to be "satisfied that the scheme is one that an intelligent and honest man, acting in respect of his interests, might reasonably approve."[42] This does not mean that the court should "form a view of whether the scheme is, in some general sense, or even in the court's own opinion, the 'fairest' or 'best' scheme."[43]

A scheme of arrangement offers a very practical mechanism to overcome the holdout problem without opening a cumbersome litigation-heavy insolvency procedure. It allows the majority of creditors to bind the minority in each creditor class. A creditor class must be "confined to those persons whose rights are not so dissimilar to make it impossible for them to consult together with a view to their common interest."[44] For approval, a scheme requires a vote of 75% by value and the majority in number of members in a class present at the meeting and voting either in person or by proxy.[45] If the requisite majority within the class is reached, the dissenting minority of creditors, including secured creditors,[46] is bound by the majority vote.

---

39 P. Wood, Principles of International Insolvency, 2nd edn, Sweet & Maxwell, 2007, para. 23-038.

40 Thus, where creditors or shareholders "give up all their rights and receive no benefit, there is no compromise or arrangement." *Re NFU Development Trust Ltd* [1972] 1 WLR 1548. In *In Re Uniq Plc* [2011] EWHC 749 (Ch), the court was satisfied that a compromise was present in a situation where the existing shareholders saw 100% of their equity stake diluted to 9.8%, but that dilution was an integral part of the restructuring that allowed the company to remain viable and survive.

41 *Re Telewest Communications plc (No. 1)* [2004] EWHC 924 (Ch); [2004] BCC 342.

42 *KCA Deutag UK Finance PLC, Re* [2020] EWHC 2977 (Ch), at 28.

43 Ibid.

44 *Sovereign Life Assurance Company v. Dodd* [1892] 2 QB 573. See also *Re Hawk Insurance Company Limited* [2002] BCC 300. For a useful review of the current position on class composition, including the distinction between rights and interests, see *In Re Lehman Brothers International (Europe) Ltd* [2018] EWHC 1980.

45 Companies Act 2006, sec. 899.

46 In this respect, schemes of arrangement are different from company voluntary arrangements (CVAs) that cannot be used to cram down secured creditors.

Upon the sanctioning of the scheme, it becomes effective and binding on the company, its creditors and shareholders involved in the scheme, including dissenting creditors and shareholders.

One important limitation of schemes of arrangement is that they do not permit a cram down of entire classes of creditors. Hence, unlike inter-class cram-down, cross-class cram down is not available in a scheme. To overcome this limitation, a sale via pre-packaged administration is often arranged. In such a case, the business or assets are transferred to a newly incorporated entity through the administrator's power of sale. The select classes of senior creditors agree by way of a scheme to take an interest in such new entity. Junior "out of the money" creditors and shareholders are left in the old company that becomes an empty shell.[47] This practice of combining pre-packaged administration and scheme of arrangements created an attractive restructuring mechanism for large companies with complex capital structures. Alternatively, a Part 26A restructuring plan may be used. Unlike schemes of arrangement, restructuring plans under Part 26A of the Companies Act 2006, recently introduced by the Corporate Insolvency and Governance Act 2020 (CIGA), permit cross-class cram down.[48] A restructuring plan may be relied on to exclude a particular class from voting on the basis that such class is out of the money or has no genuine economic interest in the relevant alternative.[49] While offering new options and additional flexibility, Part 26A restructuring plans are only available to companies which have encountered, or are likely to encounter, financial difficulties that are affecting, or will or may affect, their ability to carry on business as a going concern.[50]

3.3.2 The USA: Chapter 11 of the US Bankruptcy Code

Chapter 11 procedure of the US Bankruptcy Code was named "the most important insolvency procedure worldwide."[51] It deserves a prominent place in "the pantheon of extraordinary laws that have shaped the American

47 K. van Zwieten, Goode on Principles of Corporate Insolvency Law, 5th edn, Sweet & Maxwell, 2018, para. 12-25; C. Gerner-Beuerle, M. Schillig, Comparative Company Law, OUP, 2019, p. 959; G. McCormack, The European Restructuring Directive, Edward Elgar Publishing, 2021, para. 3.27.

48 Corporate Insolvency and Governance Act 2020, Schedule 9, part 1. See e.g. *Re DeepOcean 1 UK Ltd* [2021] EWHC 138 (Ch); *Amicus Finance Plc (In Administration)* [2021] EWHC 3036 (Ch); *Re Prezzo Investco Limited* [2023] EWHC 1679 (Ch); *In the matter of Fitness First Clubs Limited* [2023] EWHC 1699 (Ch).

49 Companies Act 2006, Part 26A, sec. 901C(4). *Re Smile Telecoms Holdings Limited* [2022] EWHC 740 (Ch).

50 Companies Act 2006, Part 26A, sec. 901A(2).

51 B. Wessels, R.J. de Weijs (ed), International Contributions to the Reform of Chapter 11 U.S. Bankruptcy Code, Eleven International Publishing, 2015, p. 2.

economy and society and then echoed throughout the world."[52] Introduced in 1978, Chapter 11 gained popularity and became a source of inspiration for insolvency laws in other countries.[53] There are several good reasons for this success.[54]

Chapter 11 permits the restructuring of the debtor's obligations by means of the adoption of a reorganisation plan. It is usually commenced by the debtor on a voluntary basis. While creditor-initiated Chapter 11 filings are possible,[55] they are rare in practice. Chapter 11 does not require material insolvency of the debtor.[56] Still, it is a matter of bankruptcy law regulated by the federal statute. Madaus explains this seeming inconsistency (debtor's solvency & bankruptcy law) by referencing the specificity of the US constitutional regime and the division of powers between the federal government and the states.[57] According to this regime, non-consensual debt impairment requires a legal basis in bankruptcy law, which belongs to the exclusive federal jurisdiction,[58] regardless of the actual insolvency of the debtor.[59]

The filing of a voluntary petition automatically opens the case with important consequences. Among them is a worldwide stay or moratorium on debt-enforcement actions by all creditors, whether secured or unsecured

---

52 E. Warren, J.L. Westbrook, The Success of Chapter 11: A Challenge to the Critics, Michigan Law Review, Vol. 107, 2009, p. 604.

53 N. Martin, The Role of History and Culture in Developing Bankruptcy and Insolvency Systems: The Perils of Legal Transplantation, Boston College International and Comparative Law Review, Vol. 28, 2005, p. 4.

54 For an overview of Chapter 11 reorganisation plans, see S.J. Lubben, American Business Bankruptcy: A Primer, Edward Elgar Publishing, 2021, Part IV.

55 11 U.S. Code §303.

56 Note that the lack of a valid reorganizational purpose may be interpreted as "bad faith" and could lead to dismissal or conversion under 11 U.S. Code §1112(b). *In re SGL Carbon Corp.*, 200 F.3d 154, 166 (3d Cir. 1999), stating that courts "have consistently dismissed Chapter 11 petitions filed by financially healthy companies with no need to reorganize under the protection of Chapter 11." More recently, financial distress as a requirement of good faith was confirmed in *In re LTL Management, LLC*, 2023 WL 1098189, at *9 (C.A.3 (N.J.), 2023), observing that the debtor's financial distress "must not only be apparent, but it must be immediate enough to justify a filing." Two inquiries are particularly relevant in this regard: "(1) whether the petition serves a valid bankruptcy purpose" and "(2) whether the petition is filed merely to obtain a tactical litigation advantage." *In re 15375 Memorial Corp. v. Bepco, L.P.*, 589 F.3d 605, 618 (C.A.3 (Del.), 2009). A valid bankruptcy purpose includes preservation of a going concern and maximizing the value of the debtor's estate.

57 S. Madaus, Leaving the Shadows of US Bankruptcy Law: A Proposal to Divide the Realms of Insolvency and Restructuring Law, European Business Organization Law Review, Vol. 19, 2018, p. 628.

58 Constitution of the United States, Article I, Section 8, Clause 4: Bankruptcy Clause: "The Congress shall have Power to establish […] uniform Laws on the subject of Bankruptcies throughout the United States."

59 Constitution of the United States, Article I, Section 10, Clause 1: Contract Clause: "No State shall […] pass any […] Law impairing the Obligation of Contracts."

(section 11.2.2.).[60] In Chapter 11, the debtor's management continues to run the business.[61] Nevertheless, in cases of fraud, dishonesty, incompetence, or gross mismanagement by directors, or if it is "in the interests of creditors, any equity security holders, and other interests of the estate", the court may appoint a bankruptcy trustee.[62] Such a bankruptcy trustee assumes the powers of the debtor's management.

Chapter 11 is a flexible instrument that enables the debtor to preserve the going concern value, while it negotiates the options for financial recovery.[63] These options should be included in the reorganisation plan, which the debtor has an exclusive right to propose within a 120-day period following the commencement of the bankruptcy proceeding.[64] A plan must designate creditor classes, specify their treatment, and provide adequate means for the plan's implementation.[65] It may prescribe such measures as the transfer of assets to other entities, extension of maturity dates, impairment of any class of claims, including claims of secured creditors, assumption, rejection, or assignment of executory contracts, and other commercially driven measures. There are important statutory requirements that must be satisfied for a plan to be confirmed by the court.[66] Some of them are mentioned below.

- First, a plan must comply with the applicable provisions and requirements of Title 11,[67] such as equal treatment of claims within the same creditor class.[68]
- Second, it must be proposed in good faith, which generally indicates that there exists "a reasonable likelihood that the plan will achieve a result consistent with the objectives and purposes of the Bankruptcy Code."[69]
- Third, the reorganisation plan should comply with the best-interest-of-creditors test.[70] This test guarantees that every dissenting creditor receives in Chapter 11 at least as much as it would have received in the

60 11 U.S. Code §362.
61 11 U.S Code §1107. Under §1101, "debtor in possession" means debtor except when a person that has qualified under section 322 of this title is serving as trustee in the case."
62 11 U.S. Code §1104.
63 On the evolving nature of Chapter 11, see M.J. Roe, Three Ages of Bankruptcy, Harvard Business Law Review, Vol. 7, 2017, p. 205, noting that instead of implementing the original idea of a deal among creditors and a debtor, Chapter 11 is now increasingly used for a market sale of distressed firms. For similar observations, see ABI Commission to Study the Reform of Chapter 11, Final Report and Recommendations, 2014, p. 15.
64 11 U.S. Code §1121(b). *Tamir v. U.S. Trustee*, 566 B.R. 278, 283 (D. Me. 2016), observing that the primary goal of Chapter 11 is to "formulate a comprehensive reorganization plan that will ultimately rehabilitate financially distressed debtors."
65 11 U.S. Code §1123(a).
66 11 U.S. Code §1129.
67 11 U.S. Code §1129(a)(1).
68 11 U.S. Code §1123(a)(4).
69 11 U.S. Code §1129(a)(3). *In re Madison Hotel Associates*, 749 F.2d 410, 424-25 (7th Cir. 1984).
70 11 U.S. Code §1129(a)(7).

Chapter 7 liquidation. Therefore, the Chapter 7 liquidation sets the baseline for distribution. The liquidation value is guaranteed to each creditor, and only the reorganisation surplus – the firm's value above the liquidation value – is subject to negotiation and voting in Chapter 11.

- Fourth, the plan should treat non-consenting classes of creditors fairly and equitably.[71] This includes compliance with the well-known absolute priority rule (APR).[72] This rule applies if a dissenting class of creditors is crammed down. The APR stipulates that no junior class can receive or retain any property under the plan unless claims of senior interests are fully satisfied. Essentially, this rule requires the plan to adhere to the order of priority entitlements under applicable non-bankruptcy law. It should be clarified that the APR focuses on the rights of a dissenting class of creditors vis-à-vis junior or senior classes and not on the rights vis-à-vis classes of the same rank. The latter is addressed by the prohibition of unfair discrimination between different classes of the same rank.[73]

Like an English scheme of arrangement, a Chapter 11 plan helps resolve the holdout problem by allowing both consensual and non-consensual plan confirmation. In the US terminology, the former means acceptance by a class, which is achieved if the majority of creditors in number and two-thirds in amount vote in favour of the plan (intra-class cram down).[74] Non-consensual plan confirmation allows a restructuring plan to be imposed or crammed down on a dissenting class of creditors (cross-class cram down) as long as at least one impaired class of creditors approved the plan and the plan complies with other requirements, such as good faith, best interest of creditors, non-discrimination, APR, fairness and equity.[75]

---

71 11 U.S. Code §1129(b)(1).

72 11 U.S. Code §1129(b)(2)(B)(ii). The APR was characterised as the "organizing principle of the modern law of corporate reorganizations", the "cornerstone of reorganization practice and theory", and "bankruptcy's most important and famous rule." See D.G. Baird, Priority Matters: Absolute Priority, Relative Priority, and the Costs of Bankruptcy, University of Pennsylvania Law Review, Vol. 165, 2017, p. 786; B.A. Markell, Owners, Auctions, and Absolute Priority in Bankruptcy Reorganizations, Stanford Law Review, Vol. 44, 1991, p. 123; M.J. Roe, F. Tung, Breaking Bankruptcy Priority: How Rent-Seeking Upends the Creditors' Bargain, Virginia Law Review, Vol. 99, 2013, p. 1236. Yet the absolute priority rule is not always absolute. For example, Chapter 11 was recently amended to address the needs of small and medium-sized firms. Small Business Reorganization Act, 11 U.S.C. §§ 1181-1195 (2019). Among other things, the new subchapter V on small business debtor reorganization stipulates that the rule of the APR does not apply in cases falling under its scope. See 11 U.S. Code § 1181(a).

73 11 U.S. Code §1129(b)(1). Thus, the US Bankruptcy Code allows discrimination between classes, as long as it is not "unfair". Courts apply different tests to determine whether discrimination is unfair. See e.g. *In Re Aztec Co.*, 107 B.R. 585 (Bankr. M.D. Tenn. 1989); *In re 203 N. LaSalle St. Ltd. P'ship*, 190 B.R. 567 (Bankr.N.D. Ill. 1995).

74 11 U.S. Code §1126(c).

75 11 U.S. Code §1129(a)-(b).

3.3.3 The Netherlands: WHOA schemes

The Dutch Bankruptcy Act (*Faillissementswet* or Fw) dates back to 1896 and has been amended several times since then. Some of the most significant changes occurred in 2020 when the Act on Court Confirmation of Extrajudicial Restructuring Plans, commonly known as WHOA, was adopted. It entered into force on 1 January 2021. In the Netherlands, discussions about the reform of the national insolvency law framework to promote the adoption of extrajudicial (out-of-court) restructuring plans began in 2012 as part of the Review of Bankruptcy Law Programme (*wetgevingsprogramma herijking faillissementsrecht*).[76] This Programme had three parts or pillars: (i) preventing fraud; (ii) enhancing restructuring options for companies; and (iii) modernising insolvency proceedings.[77] These pillars resulted in several legislative proposals, including *Wet Continuïteit Ondernemingen I*, dealing with pre-packs, and the WHOA.

Before the WHOA, restructuring options under Dutch law were limited. The existing bankruptcy procedures for legal entities – bankruptcy (*faillissement*) and suspension of payments (*surseance van betaling*) – were recognised to be inefficient in rescuing financially distressed companies.[78] Outside these formal bankruptcy proceedings, a general principle of freedom of contract applied, meaning that all affected creditors needed to consent to an out-of-court debt restructuring. This led to an acute holdout problem, as a result of which many Dutch companies resorted to English schemes of arrangement or US Chapter 11 reorganisations.[79]

According to the Dutch Bankruptcy Act, a WHOA plan can be prepared and approved through a public (publicly disclosed) pre-insolvency procedure

76 *Kamerstukken II* 2012/13, 29 911, nr. 74. For an overview of the pre-reform Dutch restructuring and insolvency regime and a detailed examination of the main features of the WHOA, see G-J. Boon, R.D. Vriesendorp, H. Koster, The WHOA: the Breakthrough for a Dutch Business Rescue Culture, HERO 2022 / W-008, 15 December 2022 <https://www.online-hero.nl/art/4464/special-issue-preventive-restructuring-8-the-whoa-the-breakthrough-for-a-dutch-business-rescue-culture> (accessed 15 July 2023).

77 S. Renssen, De herijking van het faillissementsrecht. De pijler modernisering (Recht en Praktijk nr. InsR12), Deventer: Wolters Kluwer, 2019.

78 R.D. Vriesendorp, R.M. Hermans, K.A.J. de Vries, Herijking faillissementsrecht en het informeel akkoord: gemiste kans of opportunity voor een Nederlandse scheme of arrangement? TvI 2013/12. The possibility to bind non-consenting creditors to an out-of-court agreement was limited to exceptional circumstances, where non-cooperative behaviour could be interpreted as an abuse of rights (Article 3:13 BW). See HR 12 August 2005, *NJ* 2006/230, m.nt. P. van Schilfgaarde (*Groenemeijer/Payroll*); HR 24 March 2017, *NJ* 2017/466, m.nt. F.M.J. Verstijlen (*Mondia/V&D*).

79 E.g. Van Gansewinkel Groep B.V., Indah Kiat International Finance Company B.V., Estro Groep B.V., Magyar Telecom B.V., Metinvest B.V., HEMA B.V.

or by way of a non-public procedure.[80] It is available to debtors that are in a situation in which it may reasonably be assumed that they will not be able to pay their debts as they fall due.[81] As for substantive rules, a WHOA scheme is a flexible legal instrument that allows companies in financial distress to restructure their debt in a cost-efficient way. It combines the elements of English schemes of arrangement, like the ability to implement restructuring outside a formal, heavily supervised bankruptcy proceeding, with characteristic features of Chapter 11, including the protection of rescue financing, cross-class cram down,[82] stay of individual enforcement actions (section 11.2.3.),[83] possibility to terminate executory contracts at the debtor's request[84] and limitation of ipso facto clauses.[85] These are some of the tools in the WHOA toolbox that can be used to assist the debtor in its restructuring efforts. After their introduction in 2021, WHOA schemes have demonstrated their effectiveness,[86] and have been used by large multinational businesses like Steinhoff and Vroon.

The inherent flexibility of the Dutch scheme extends to the possible contents of a restructuring plan. It may include a debt-for-equity swap, a (partial) write-off or extension of debt, a sale of debtor's assets, or a combination of these and other measures. The WHOA plan can affect the rights of secured, preferential, unsecured and subordinated creditors and shareholders, but it cannot release or reduce liabilities arising from employment contracts.[87] Once approved by the requisite majorities in each class of creditors or shareholders (two-thirds in value of those who participated in the voting),[88] and subject to court confirmation,[89] the plan becomes binding on all affected creditors and shareholders.[90] Thus, just like English schemes of arrangement and US Chapter 11 plans, WHOA plans may be utilised to overcome a holdout problem and restore financial viability through debt restructuring. Notably, all three procedures mentioned in this section of the book contain rules that can facilitate group restructuring. We will explore these rules throughout this book.

80 Dutch Bankruptcy Act, Article 369, indicating that apart from the jurisdictional rules, the only major distinction between a public and a non-public proceeding is that, unlike the latter, a public proceeding is publicly disclosed in insolvency and trade registers. In addition, requests to court are heard in open sessions.
81 Dutch Bankruptcy Act, Articles 370(1) and 371(3).
82 Dutch Bankruptcy Act, Articles 383(1) and 384.
83 Dutch Bankruptcy Act, Article 376.
84 Dutch Bankruptcy Act, Article 373(1).
85 Dutch Bankruptcy Act, Article 373(3).
86 F. Damsteegt, M.J.P. Vink, Jaarverslag Rechters-WHOA-Pool 2021 en 2022.
87 Dutch Bankruptcy Act, Article 369(4).
88 Dutch Bankruptcy Act, Article 381(7).
89 Dutch Bankruptcy Act, Articles 383-384.
90 Dutch Bankruptcy Act, Article 385.

3.4 From a Single Entity to a Single Enterprise?

3.4.1 Why recognition of enterprise groups in insolvency law took so long

An overview of major milestones in the development of insolvency law and its recognition of enterprise groups as a commercial reality that needs to be acknowledged and reckoned with depicts a modest and uneasy progression. This section explores the likely reasons behind this slow pace and discusses the probable causes or triggers for a recent shift represented by the third generation of insolvency law instruments.

There are several reasons why, for a long time (and perhaps still), insolvency law has largely remained single entity-focused, resulting in the entity-by-entity treatment of enterprise group members in financial distress (entity bias).

First, in discussing the failure of English law to devise a special group law or a comprehensive set of rules to regulate liability within groups, Davies points out that this is probably because "group structures and relationships within groups are highly variable and the appropriate general rules are accordingly difficult to identify."[91] Indeed, enterprise groups differ in terms of the size, legal organisation, management, financing, and business integration (section 2.4.). This variability complicates the adoption of general company and insolvency law on groups that would be sufficiently certain and predictable but also flexible enough to suit all types of groups.

Second, the entity-centric vision in insolvency is firmly grounded in the long-established principle of company law, namely entity separateness, in modern times underpinned by limited liability and entity shielding. In this respect, Teichmann notes that "company law of most jurisdictions is still focussed on the single legal entity and does not expressly acknowledge the fact that the corporate group may create legal challenges which are different from those of an independent company."[92] Unlike a legal entity, an enterprise group does not have its own legal personality. As a result, (i) assets in a group of companies are separated along the entity lines (one entity – one insolvency estate), (ii) creditors have legal rights (recourse) only with respect to particular entities and their assets, and (iii) IPs appointed in individual companies act in the interests of such companies and their creditors. Wessels and Madaus call this a "five one's" principle as it establishes "one insolvent debtor, one estate, one insolvency proceeding, one court and one

91 P. Davies, Introduction to Company Law, 3rd edn, OUP, 2020, p. 259.

92 C. Teichmann, Towards a European Framework for Cross-Border Group Management, European Company Law, Vol. 13, 2016, p. 150.

insolvency office holder."[93] The fact that before insolvency a group operated as one integrated enterprise does not easily fit this atomistic vision.

Third, the very concept of a "group of companies" has not been comprehensively developed or harmonised across jurisdictions. While some countries apply general corporate and/or civil law to corporate groups (e.g. the UK), other countries apply special rules (e.g. Germany, Portugal, Slovenia).[94] Nevertheless, there is some convergence when it comes to the agency problems arising in groups, including conflicts between majority and minority shareholders, and between shareholders and creditors. This convergence is evident in the rules concerning related-party transactions. In most EU Member States, but also outside Europe, company and insolvency laws usually prescribe special treatment of transactions involving related parties – directors, shareholders and their affiliates. In company laws, this results in additional safeguards against intra-group self-dealing, including mandatory bid rules,[95] allocation of certain rights to minority shareholders (e.g. appraisal rights), and disclosure and approval requirements.[96] In insolvency law, the interests of insiders often enjoy lesser protection and their rights may be subordinated to the rights of external creditors.

However, the recognition of corporate groups faces significant obstacles and even resistance whenever the principle of entity separateness is at stake. This is clearly exemplified by the discussions over the recognition of a "group interest" in European company law.[97] In 2011, the Reflection Group on the Future of EU Company Law, set up by the European Commission in 2010, issued a Report recommending the recognition of a group interest at the EU level.[98] The group argued that this would enhance the flexibility of group management in international business activities and facilitate

93 B. Wessels, S. Madaus, Rescue of Business in Insolvency Law. Instrument of the European Law Institute, 2017, p. 342.

94 K.J. Hopt, Groups of companies: A Comparative Study of the Economics, Law, and Regulation of Corporate Groups, in J.N. Gordon and W-G. Ringe (eds), The Oxford Handbook of Corporate Law and Governance, OUP, 2018, p. 612.

95 See e.g. Article 5, Directive 2004/25/EC of 21 April 2004 on takeover bids. L. Enriques, The Mandatory Bid Rule in the Takeover Directive: Harmonization Without Foundation? European Company and Financial Law Review, Vol. 1, 2004, pp. 440-457.

96 J. Dammann, Related Party Transactions and Intragroup Transactions, in L. Enriques and T.H. Tröger (eds), The Law and Finance of Related Party Transactions, CUP, 2019, pp. 218-244.

97 Forum Europaeum Corporate Group Law, Corporate Group Law for Europe, EBOR, Vol. 1, 2000, pp. 165-264, recommending the introduction of a modified *Rozenblum* doctrine at the European level; Report of the High Level Group of Company Law Experts on a Model Regulatory Framework for Company Law in Europe ("Winter Report"), 2002, noting that it is feasible to establish a framework rule that allows the adoption and implementation of a group policy, provided that the interests of creditors are sufficiently protected.

98 Report of the Reflection Group on the Future of EU Company Law, Brussels, 5 April 2011.

legal certainty.[99] Based on the Report, a public consultation was launched regarding the recognition of a group interest. It resulted in the Company Law Action Plan that included the initiative to recognise the concept of a group interest.[100] Despite the generally positive attitude of academics and the business community towards the EU-wide move for the acceptance of a group interest,[101] this initiative has not led to a concrete legislative proposal, highlighting its complex and controversial character. The idea of an EU framework covering groups of companies was also met with caution.

The entity-by-entity treatment of group companies and their insulation in insolvency is criticised for not reflecting the economic interconnectedness of entities within the group, further entrenched by the widespread use of intra-group guarantees and loans.[102] As an alternative to the "single entity approach", a "single enterprise approach" is suggested.[103] This approach aims to give effect to interrelations between group members and may treat the group as a single economic unit, which operates to promote the interests of a group as a whole. The appearance of group-mindful insolvency rules supports this approach. But what can explain their appearance? The growing body of scholarship devoted to enterprise groups and the accumulation of practical experience in dealing with group failures might have contributed to it. Yet this is not sufficient to explain the recent legislative changes. After all, there should be political will to embrace new ideas. The following sections discuss two processes that could have served as a trigger for or have facilitated the move to the third generation.

---

99 The Report did not elaborate the application of a group interest in a group insolvency scenario, only noting that further consideration of this principle should distinguish between two situations: (i) where a subsidiary is not close to insolvency or insolvent, and (ii) where a subsidiary is close to insolvency or insolvent.

100 Action Plan: European company law and corporate governance – a modern legal framework for more engaged shareholders and sustainable companies, COM/2012/0740 final.

101 P-H. Conac, Director's duties in groups of companies – legalizing the interest of the group at the European level, European Company and Financial Law Review, Vol. 10, 2013, pp. 194-226; M. Winner, Group interest in European company law: an overview, Acta Univ. Sapientiae, Leg. Stud., Vol. 5, 2016, pp. 85-96; The Informal Company Law Expert Group, Report on the recognition of the interest of the group, 2016, advocating for the incorporation of a group interest with respect to wholly owned subsidiaries. It stressed that clarity over such interest was essential to encourage intra-group financing, ultimately contributing to the EU's Capital Markets Union objectives.

102 H. Hansmann and R. Squire, External and Internal Asset Partitioning: Corporations and Their Subsidiaries, in J.N. Gordon and W-G. Ringe (eds), The Oxford Handbook of Corporate Law and Governance, OUP, 2018, p. 259, generally noting that internal corporate partitioning does not generate the many benefits often attributed to it.

103 The dichotomy between "single entity approach" and "single enterprise approach" is described in the UNCITRAL Legislative Guide on Insolvency Law, Part three. Mevorach uses slightly different terms "entity law" and "enterprise law". I. Mevorach, Transaction Avoidance in Bankruptcy of Corporate Groups, European Company and Financial Law Review, Vol. 8, 2011, pp. 235-258; P. Blumberg, The Corporate Entity in an Era of Multinational Corporations, Delaware Journal of Corporate Law, Vol. 15, 1990, pp. 283-375.

3.4.2 The Global Financial Crisis as an accelerator of change

Milton Friedman famously wrote:

> Only a crisis – actual or perceived – produces real change. When that crisis occurs, the actions that are taken depend on the ideas that are lying around. That, I believe, is our basic function: to develop alternatives to existing policies, to keep them alive and available until the politically impossible becomes politically inevitable.[104]

The Global Financial Crisis (GFC) was an "actual" crisis that pushed far-reaching reforms in the financial industry. It led to what we refer to as the "GFC-effect". The GFC demonstrated that the lack of a comprehensive regulatory framework applicable to banks and banking groups covering their supervision and resolution could lead to their disorderly collapses. In its 2010 report, the BCBS concluded that "[e]xisting national legal and regulatory arrangements are not designed to coordinate the resolution of problems in all of the significant legal entities of a financial group operating through a multiplicity of separate legal entities."[105] This is because "insolvency rules apply on a legal entity basis."[106] This meant that the predominant approach to resolving banking crises was territorial or nation-based.

The insolvency of Icelandic banks serves as a prime example of this nation-based approach. Following the crisis of Iceland's outsized banking industry in the summer-autumn of 2008, the Icelandic government passed emergency legislation granting protection to domestic deposits. Domestic deposits were transferred to new banks, while foreign operations and deposits remained in the old banks, which were placed under administration. Baudino et al. explain that the purpose of this exclusion of foreign depositors was to "maintain basic banking services for domestic economy by separating domestic operations from the larger foreign operations of each bank."[107] However, this differential treatment raised concerns over equal treatment of creditors. Ultimately, foreign depositors had to be rescued by foreign (i.e. Dutch and UK) governments.[108] After Iceland declined

---

104 M. Friedman, Capitalism and Freedom, The University of Chicago Press, 2020 (originally published in 1962), Preface 1982.

105 BCBS, Report and Recommendations of the Cross-Border Bank Resolution Group, March 2010, p. 25.

106 Ibid.

107 P. Baudino, J.T. Sturluson and J-P. Svoronos, The Banking Crisis in Iceland, FSI Crisis Management Series No. 1, March 2020, p. 2.

108 D. Schoenmaker, Governance of International Banking: The Financial Trilemma, OUP, 2013, Chapter 4.2. See also P. Davies, Resolution of cross-border groups, in M. Haentjens and B. Wessels (eds), Research Handbook on Crisis Management in the Banking Sector, Edward Elgar Publishing, 2015, pp. 263-265.

to offer compensation to depositors in the Netherlands and the UK, a case was brought before the EFTA Court.

In its judgment from 28 January 2013, the EFTA Court took the side of Iceland, ruling that the applicable law (i.e. the EU Deposit Guarantee Directive)[109] did not impose an obligation on the EEA states to ensure the payment of aggregate deposits in all circumstances, including when the deposit guarantee scheme was unable to fulfil its obligations in the event of a systemic crisis. The court ruled out the existence of an "obligation of result". It also dismissed allegations concerning discriminatory treatment of deposit holders, holding that "the transfer of domestic deposits – whether it leads in general to unequal treatment or not – does not fall within the scope of the non-discrimination principle."[110] According to the EFTA Court, "the principle of non-discrimination requires that there is no difference in the treatment of depositors by the guarantee scheme itself and the way it uses its funds."[111] In the case at hand, the guarantee scheme was not involved in the transfer of deposits. In 2009, the Deposit Guarantee Directive was amended. It now stipulates that the Member States shall ensure a certain coverage level for deposits.[112] Yet the question of a state guarantee in a situation where there are insufficient funds in a deposit guarantee scheme to pay all depositors remains unresolved.[113]

In response to the GFC and the numerous problems it brought to light, the Financial Stability Board (FSB), an international body responsible for monitoring and making recommendations about the global financial system, issued the influential Key Attributes of Effective Resolution Regimes for Financial Institutions (Key Attributes).[114] These are internationally recognised standards for credit institutions, aimed at facilitating an orderly resolution of banks without causing severe systemic disruption or exposing taxpayers to losses, while safeguarding critical services and functions. The Key Attributes clearly recognise the existence of banking groups and provide for the rules to take group integration and interdependence into

109 Directive 94/19/EC of 30 May 1994 on deposit-guarantee schemes (now repealed by Directive 2014/49/EU of 16 April 2014 on deposit guarantee schemes (recast)).

110 Judgment of the EFTA Court, *EFTA Surveillance Authority v. Iceland*, E-16/11, 28 January 2013, para. 216 <https://eftacourt.int/download/16-11-judgment/?wpdmdl=1260> (accessed 15 July 2023).

111 Ibid., para. 210.

112 Deposit Guarantee Directive, Article 6.

113 E.G. Gunnarsson, The Icelandic Regulatory Responses to the Financial Crisis, EBOR, Vol. 12, 2011, pp. 1-39.

114 Key Attributes of Effective Resolution Regimes for Financial Institutions, 4 November 2011. The Key Attributes were revised in 2014 with additional annexes that set out implementation guidance.

consideration when preparing for resolution and implementing resolution tools. These rules cover various aspects, including (i) group recovery and resolution plans (KA 11), (ii) crisis management groups (KA 8), (iii) assessment of group resolvability (KA 10),[115] and (iv) access to information and information sharing (KA 12).[116] The Key Attributes reflect the specificity of banking groups and emphasise the need to prepare for and conduct resolution in view of such specificity. They served as a basis for the BRRD and the SRMR, which lay down several provisions relevant for banking groups.

The complexity and interconnectedness of financial institutions (e.g. arising from intra-group transactions, deposits with each other, ownership of securities issued by other banks[117]) coupled with the potential drastic consequences of their failure (systemic risk) were the driving force behind the legal recognition of banking groups in rules on bank resolution. The GFC effect showcased that "bank risk-taking has a systematic, as opposed to idiosyncratic (firm-specific), character."[118] It prompted the regulation transpiring a single entity. A group-mindful regulation of banks is closely tied to public interest considerations and the significant negative externalities associated with bank failures.

3.4.3 The rise of the rescue culture

The rise of the rescue culture is characterised by the proliferation of national laws seeking to promote the restructuring of viable enterprises facing financial difficulties and to minimise the negative impact of their failures. Over the last decade, several countries, including Singapore,[119] the UK, the Neth-

115 Ibid. Group resolvability assessment should consider how "interconnections or interdependencies between group entities through intra-group transactions […] affect the implementation of the resolution strategy."

116 According to KA 12, firms should be required to "maintain specific information at a legal entity level, including, for example, information on intra-group guarantees and intra-group trades booked on a back-to-back basis."

117 W-G. Ringe, J. Patel, The Dark Side of Bank Resolution: Counterparty Risk through Bail-in, EBI Working Paper Series 2019, No. 31, 2019, observing that the current regulatory framework encourages increased interconnections between banks and noting that financial institutions' investment in securities issued by other financial institutions has been on the rise since 2016 (introduction of the bail-in tool in the EU).

118 J. Armour, J.N. Gordon, Systemic Harms and Shareholder Value, Journal of Legal Analysis, Vol. 6, 2014, p. 38.

119 M.S. Wee, The Singapore Story of Injecting US Chapter 11 into the Commonwealth Scheme, European Company and Financial Law Review, Vol. 15, 2018, pp. 553-584; A. Gurrea-Martínez, Building a Restructuring Hub: Lessons from Singapore, SMU Yong Pung How School of Law Research Paper 16/2021, 11 October 2021 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3940512> (accessed 15 July 2023).

erlands, Spain,[120] France[121] and Germany, to name a few, have established restructuring-friendly legislation.[122]

The expansion of restructuring laws is likely to continue. In the EU, this trend is influenced by the Restructuring Directive, which had to be transposed into national laws of all EU Member States by 17 July 2021, with a possible extension of up to one year. Although this directive does not aim to fully harmonise 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 also maximises the total value available to creditors.[123] The importance of a timely reaction to financial struggles is emphasised in the literature.[124] Janger observes that the "concept of rescue originates in the idea that, sometimes, even insolvent businesses are worth more in operation than they are in liquidation."[125] While in the USA the idea of business rescue can be traced back to railroad receiverships of the early 1900s,[126] in many countries, the idea of a value-maximising rescue is relatively novel.

A successful restructuring, which maintains and maximises the going concern value, often relies on preserving group synergies, organisational and financial links within a group of companies. This is directly acknowledged by the EIR Recast, which provides that "cooperation should be aimed at

120 I. Tirado, Scheming against the Schemes: A New Framework to Deal with Business Financial Distress in Spain, European Company and Financial Law Review, Vol. 15, 2018, pp. 516-552.

121 E. Ghio, Transposing the preventive restructuring directive 2019 into French insolvency law: Rethinking the role of the judge and rebalancing creditors, International Insolvency Review, Vol. 30, 2021, pp. 54-74.

122 D.C. Ehmke et al., The European Union preventive restructuring framework: A hole in one? International Insolvency Review, Vol. 28, 2019, p. 185, observing that the recent reforms in Europe "were aimed at establishing a more restructuring-friendly culture in Europe, espousing a rescue culture for insolvency frameworks."

123 Restructuring Directive, Recital 2.

124 L. Stanghellini et al. (eds), Best Practices in European Restructuring. Contractualised Distress Resolution in the Shadow of the Law, Wolters Kluwer, 2018, p. 4, 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."; B. Wessels and S. Madaus, Rescue of Business in Insolvency Law. Instrument of the European Law Institute, 2017, Recommendation 1.21, stressing the value of supporting "early warning mechanisms that detect a deteriorating business development and signal the respective urgency to act."

125 E. Janger, The idea of rescue and the Chapter 11 model, in P.J. Omar and J.L.L. Gant (eds), Research Handbook on Corporate Restructuring, Edward Elgar Publishing, 2021, p. 59.

126 D.A. Skeel, An Evolutionary Theory of Corporate Law and Corporate Bankruptcy, Vanderbilt Law Review, Vol. 51, 1998, p. 1354, explaining the context of flexible, reorganisation based corporate bankruptcy: "Almost everyone agreed that the railroads could not be permitted to fail. Unlike most other corporations, railroads served a crucial public function that was essential to the nation's growth".

finding a solution that would leverage synergies across the group."[127] Even though the Restructuring Directive does not have provisions specifically targeting group restructurings, it accepts that the coherence of restructuring and insolvency proceedings should promote the restructuring of groups of companies, irrespective of the location of group members within the EU.[128] It mentions that Member States may decide to implement group-mindful mechanisms, such as applying a stay for the benefit of third-party security providers, including guarantors and collateral givers.[129] Thus, the introduction of group-mindful insolvency rules has coincided with the rise of rescue as one of the leading ideologies of modern corporate insolvency law.[130] Whereas it is difficult to establish a causal link between the two, the correlation is noticeable.

The preservation of the group's going concern value, critical for group restructuring, is promoted by cooperation and communication between courts and IPs,[131] joint administration of insolvency proceedings, granting powers to IPs to intervene in proceedings concerning other group entities,[132] coordinating the appointment of IPs,[133] allowing third-party releases, extending an insolvency stay to group affiliates, and facilitating intra-group (rescue) financing.

In conclusion, the rationale and policy goals that determine or influence the development of the third generation of insolvency laws vary. After the GFC, regulation of bank failures is built around the concept of group resolvability, primarily focused on the preservation of banks' critical functions, protection of public funds and mitigation of systemic risk – macroprudential goals associated with wider social costs and negative externalities. It therefore does not have as its main purpose the maximisation of value.[134] By contrast,

127 EIR Recast, Recital 52.
128 Restructuring Directive, Recital 15.
129 Restructuring Directive, Recital 32.
130 The question whether the rehabilitation of a debtor's business is a legitimate objective of insolvency law on its own, or whether it only matters to the extent that it can maximise recoveries for existing entitlement holders, is beyond the scope of this book. For discussion of different positions, see K. van Zwieten, Goode on Principles of Corporate Insolvency Law, 5th edn, Sweet & Maxwell, 2019, at 2-15 to 2-19.
131 The EIR Recast and the MLEGI establish that IPs and courts *shall* cooperate and communicate with each other to the maximum extent possible. EIR Recast, Articles 56-58 and MLEGI, Articles 9 and 14.
132 EIR Recast, Article 60, allowing an IP to request a stay of realisation of assets in proceeding concerning another group member. Also, MLEGI, Article 20, covering relief available to a planning proceeding.
133 EIR Recast, Article 57; MLEGI, Article 17.
134 E. Martino, The Bail-in Beyond Unpredictability: Creditors' Incentives and Market Discipline, European Business Organization Law Review, Vol. 21, 2020, p. 821, arguing that "preserving financial stability and protecting property rights clearly outweigh market discipline in terms of minimising resolution costs and avoiding the destruction of value."

the business rescue narrative is linked to maintaining operational continuity, retaining the enterprise's human resources, and preserving business relationships to maximise the insolvency estate value of an enterprise group and its constituent members.

3.5 Limits of a Single Enterprise Approach

3.5.1 Limits of group resolvability

The post-GFC bank resolution regime recognises that banks often operate as integrated cross-border groups of companies – banking groups. In view of this, it has adjusted its approach to address group financial distress through the use of special tools, such as group recovery and resolution planning,[135] group financial support arrangements, preparation and execution of models of bank resolution, subject to ex ante pre-positioning of resources and liabilities within a group.[136]

One cannot help but notice that the group-mindful regulation of banks is more comprehensive and developed compared to rules applicable in the insolvency of non-financial enterprises, which mostly focus on enhanced cooperation, communication and coordination. This divergence may stem from the specific goals pursued by bank resolution and the underlying system of values. The latter is primarily concerned with the preservation of banks' critical functions and national, regional and global financial stability. This policy mandates a departure from a narrow entity-by-entity and territorial approach. Nevertheless, the extent of such a departure should not be overstated. On closer examination, we can observe that the essence of entity separateness is diligently preserved in bank resolution.

First, even the BRRD, which establishes an elaborate EU-wide framework on bank resolution, does not permit the application of resolution tools to a banking group as a whole, as if it is a single legal entity. Instead, resolution tools can only be applied at the level of separate group members (parent or subsidiary companies), unless national insolvency law provides for a group treatment.[137] Elke König, the former Chair of the Single Resolution Board

135 An obligation to prepare resolution plans or "living wills" was introduced after the GFC both in the USA (Dodd-Frank Act, section 165(d)) and in the EU (BRRD, Article 12). These plans generally cover a banking group globally and should reflect its corporate, operational and legal interconnectedness, and contain the steps to ensure group resolvability.

136 The two main models or strategies for bank resolution are a SPOE model and a MPOE model. They should be aligned with the group's corporate, operational and financial structure and serve as a basis for an orderly resolution.

137 J. Deslandes and M. Magnus, Further Harmonising EU Insolvency Law from a Banking Resolution Perspective? April 2018, p. 7.

(SRB), noted that "in the current framework insolvency is clearly entity-specific […]."[138] Under the BRRD, "group resolution" means either the taking of a resolution action at the level of a parent undertaking or an institution subject to consolidated supervision (with a view to resolving the whole or a part of the group), or the coordination of the application of resolution tools and the exercise of resolution powers by resolution authorities in relation to group entities that meet the conditions for resolution.[139] In both cases, the separateness of group members is safeguarded, as resolution tools are applied on an entity ("resolution entity") basis – the only difference being in the level of such an entity within the banking group structure.

Second, the well-known no-creditor-worse-off (NCWO) principle, applicable in resolution and protecting creditors' and shareholder's rights, operates at an entity and not at a group level. Thus, a resolution tool should not worsen the position of a creditor compared to its position in a situation of normal insolvency proceedings, even if such resolution increases the combined net value of the banking group.[140] The European Banking Authority (EBA) clarifies that "the NCWO assessment has to be performed at the level of each group entity subject to resolution measures."[141] Yet it accepts that the ultimate assessment depends on whether national insolvency law provides for special treatment of groups of companies, inter alia, by recognising group interest or mandating subordination of intra-group claims.[142] That being said, at this moment, the vast majority of EU Member States do not have tailored substantive legislation addressing the insolvency of groups of companies or explicitly recognising group interest.

Third, a closer look at group-specific rules reveals their limitations. Take, for instance, group financial support agreements under the BRRD, further examined in Chapter 12. While these agreements could take into account group interest, they must not compromise the liquidity or solvency of the providing entity as a result of granting financial support to other (receiving)

---

138 E. König, Real defragmentation of the Banking Union: the way forward, Eurofi, 17 December 2019 <https://srb.europa.eu/en/node/544> (accessed 15 July 2023).

139 BRRD, Article 2(1)(42).

140 BRRD, Articles 73-75. A breach of the NCWO principle gives rise to a compensation claim by affected creditors or shareholders.

141 NCWO principle in a group resolution, Single Rulebook Q&A, Question ID 2015_2458 <https://www.eba.europa.eu/single-rule-book-qa/-/qna/view/publicId/2015_2458> (accessed 15 July 2023).

142 Ibid. See also D. Singh, European Cross-Border Banking and Banking Supervision, OUP, 2020, pp. 137-138, underscoring that the NCWO principle "provides a balance between the competing public and private interests", but recognising that in a group "it is likely that the [NCWO principle] will lead to different outcomes for the creditors of the different incorporated entities."

group entities.[143] In other words, group interest should not trump or sacrifice the interests of individual group entities and their respective creditors. Besides, the BRRD does not seek to introduce an overarching concept of a group interest. The group interest surfaces in a clear way only in the provisions on intra-group financial support.[144]

3.5.2 Limits of a group-centric vision in corporate insolvency law

While estate value preservation and maximisation may require the adoption of a group-centric vision in insolvency, the position of creditors is usually assessed at a single entity level. This is based on the fact that, in the absence of substantive consolidation, the separateness of assets and liabilities is preserved. Any relationship – whether by shareholding or otherwise – to another legal entity within an enterprise group in this respect usually becomes irrelevant.

This is why, just like the NCWO principle, the best-interests-of-creditors test is calculated with respect to each separate entity subject to a restructuring plan. This test provides a reference point or a minimum baseline, which shields individual creditors and shareholders and ensures protection of property rights.[145] Thus, a reorganisation plan should not be approved if it does not comply with this benchmark scenario unless the affected parties consent to it.[146] This means that the utilitarian vision of group interest cannot prevail over and harm the interest of individual entities and their creditors. However, this does not imply that the individual interest should be separated from a group interest, because the two are often aligned with each other. The problem arises where such interests are in conflict.

The limits of a single enterprise approach are also evident in the restrictions imposed on cross-border communication and cooperation and the appointment of the same IP. For example, the EIR Recast prescribes that in a group insolvency context, courts and IPs shall communicate and cooperate to the extent that it does not entail any conflict of interest.[147] Such conflicts may occur in a situation of a dispute between group members and concern the enforcement of intra-group claims, transaction avoidance actions and

143 BRRD, Article 23(1)(e).
144 E. Ferran and L.C. Ho, Principles of Corporate Finance Law, 2nd edn, OUP, 2014, p. 41.
145 S. Madaus, Leaving the Shadows of US Bankruptcy Law: A Proposal to Divide the Realms of Insolvency and Restructuring Law, EBOR, Vol. 19, 2018, p. 638.
146 Restructuring Directive, Articles 2(1)(6), 10(2)(d).
147 EIR Recast, Articles 56-58. On conflicts of interest in group insolvencies, see I. Kokorin, Conflicts of interest, intra-group financing and procedural coordination of group insolvencies, International Insolvency Review, Vol. 29, 2020, pp. 32-60.

the allocation or transfer of assets within the group.[148] Moss and Smith point out that whenever there is a disputed claim between two group entities, an obligation for IPs to cooperate may "need to be circumscribed accordingly."[149] This is due to the fact that such cooperation can result in the exchange of information that can prove instrumental in substantiating a claim of one group entity against another, potentially to the detriment of the latter. Schmidt provides another example of a situation in which cooperation could be limited – where it entails (gratuitous) "transmission of valuable know-how, patents, or business secrets, or making assets available to other group members which could have been disposed of with a large profit for the individual group member."[150] Again, this is an example of conflicting interests of group members in insolvency.

This problem is magnified if the same IP is appointed to administer the proceedings of several members of an enterprise group with complex financial and business relations and different groups of creditors.[151] Obtaining complete information, otherwise unavailable, might compel an IP to lodge a claim on behalf of one enterprise group member against another one, therefore making him/her represent both the claimant and the respondent. Another example relates to the extension of cross-guarantees or provision of post commencement financing, which may benefit one entity (i.e., company, receiving financing or a guarantee) to the detriment of another entity (i.e., provider of financing, guarantee or collateral). Essentially, the "double" IP needs to negotiate with him/herself the appropriateness of these measures and their characteristics (e.g., amount, compensation, timeframe, security). This is an epitome of the "two masters" problem.

---

148 Legislative Guide, Part three, Ch. II, para. 68, referring to a situation of intra-group rescue financing where a "conflict of interest might arise, for example, in balancing the interests of the group as a whole against the potentially different interests of the lender and the receiver of post-commencement finance." See Lehman Brothers Insolvency Protocol (2009), para. 4.6., stating that "Each Official Representative should cooperate in the gathering and sharing of certain data and share analysis of certain transactions by […] coordinating in good faith the investigations of pre-filing activities with any other Official Representative with an interest in such activities, so long as the interests of the Official Representatives coordinating such investigations do not diverge […]."

149 G. Moss and T. Smith, Commentary on Regulation 1346/2000 and Recast Regulation 2015/848 on insolvency proceedings, in G. Moss, I. Fletcher, S. Isaacs (eds), Moss, Fletcher and Isaacs on the EU Regulation on insolvency proceedings, 3rd edn, OUP, 2016, para. 8.754.

150 J. Schmidt, Commentary to Article 56, in R. Bork, K. van Zwieten (eds), Commentary on the European insolvency regulation, OUP, 2016, para. 56.22.

151 Given the prominence of these conflicts, Van Galen notes that "[i]t is remarkable that there are many domestic cases in which the same liquidator is appointed in the insolvency proceedings of more than one group company." He observes that "conflicts of interests between individual group companies may be much more pronounced in insolvency proceedings." R. van Galen, Insolvent Groups of Companies in Cross Border Cases and Rescue Plans, Report to the Netherlands Association for Comparative and International Insolvency Law (8 November 2012), para. 70.

The main idea behind restricting communication and cooperation or the appointment of a single IP in a situation of a conflict of interest is to minimise the potential harm that may otherwise be caused to the interests of individual group members (and their creditors), which maintain a separate legal identity. Restrictions are imposed to avoid the impairment in value of one entity's insolvency estate to the benefit of another group entity's insolvency estate or the combined net group value.

3.6 Conclusion

This chapter highlights that despite the exponential growth of multinational enterprise groups over the 20th century, insolvency law has mainly focused on separate entities within the group. This single entity approach rests on the difficulty of defining a corporate group, the diversity of group types and structures, and the unease of fitting any group rules into the prevailing frameworks of company and insolvency law, still largely dominated by the doctrines of legal separateness, limited liability and entity shielding. However, over the last few decades, insolvency law has experienced transformative developments.

These developments were accelerated by the GFC, which exposed the interconnectedness of financial institutions and the need to address systemic risks of their failure at a group (macro) level. At the same time, for non-financial firms, the emergence of insolvency law instruments recognising the group economic reality is linked to the rise of laws which aim to preserve debtors' business and a going concern value through restructuring. The achievement of this goal could be undermined if group operational continuity is broken in insolvency. In many jurisdictions, new procedures have been established to help ailing debtors solve financial problems, overcome holdouts and reduce the debt burden. In this chapter, we introduce three procedures that are frequently used to effectuate debt restructuring, including within enterprise groups. These are UK schemes of arrangement, US Chapter 11 reorganisations and Dutch WHOA plans.

The question is how group-sensitive insolvency law can be reconciled with the doctrine of entity separateness explored in the previous chapter. When answering this question, it is important to recognise that there are different ways in which law can respond to the challenges created by group insolvencies. One can think of a continuum of legal tools, ranging from a complete disregard of the corporate form and limited liability (e.g. substantive consolidation) to the less intrusive tools, including third-party releases, extended enforcement stays, invalidation or approval of intra-group transactions (e.g. cross-guarantees), limited enforceability of certain contractual provisions (e.g. cross-entity ipso facto and cross-default clauses), and simple coordination of separate proceedings concerning group entities. Some of

these tools will be discussed in the subsequent chapters of this book. At this point, it suffices to stress that the majority of them do not touch upon the core of entity separateness – limited liability and entity shielding. Whereas group-sensitive rules do not need to interfere with this core, it is less clear what their design should look like.

Part III

Principles of Insolvency Law and How to Balance Them

4 Principles of Insolvency Law and Principle-based Approach▪

4.1 Introduction

Commenting on the methodological foundations of modern law scholarship, Burrows observes that "we rarely find doctrinal scholars analysing the precise methodological approach that they are adopting."[1] When interpreting law and making normative suggestions one can rely on different methods. For example, one can use economic arguments, examining law from ex ante and ex post positions.[2] Empirical research methods are also becoming more popular. Another method is to focus on underlying legal principles. This method is embraced by this book, in combination with comparative analysis and periodic references to pragmatic or economic arguments.

In the choice of the research methodology, we are inspired by the writings of Reinhard Bork, professor at the University of Hamburg (Germany).[3] In his works, Bork collects and describes the main principles of international and national insolvency law, systematises and contextualises them, and devotes attention to the benefits of using principles as a tool to examine and better understand law, and to make suggestions for its improvement. Wessels notes that the "principle-based approach provides inspiration for evaluating research and may lead to reconsider proposals for shaping and

---

▪ This chapter builds upon the following previously published work by the author:
- I. Kokorin, Intra-Group Financial Support in a Crisis: Between Rescue and Abuse, Norton Journal of Bankruptcy Law and Practice, Vol. 29, 2020, pp. 378-420.
- I. Kokorin, The Rise of 'Group Solution' in Insolvency Law and Bank Resolution, European Business Organization Law Review, Vol. 22, 2021, pp. 781-811.
- I. Kokorin, B. Wessels, annotation: European Court of Human Rights 5 July 2018, no. 41299/09 & 11132/10, *JOR* 2019, 3; 778-790 (*JOR* 2019/64, *Boyadzhieva and Gloria International Limited Eood v. Bulgaria*).

1 A. Burrows, Remedies for Torts, Breach of Contract, and Equitable Wrongs, OUP, 4th edn, 2019, p. 21.

2 R. Posner, Economic analysis of law, 8th edn, Austin, TX: Wolters Kluwer Law & Business, 2010.

3 R. Bork, Corporate Insolvency Law. A Comparative Textbook, Intersentia, 2020; R. Bork, Principles of Cross-Border Insolvency Law, Intersentia, 2017. The principle-based approach was followed in a more recent book, written by Bork together with Michael Veder, professor at Radboud University (the Netherlands). See R. Bork and M. Veder, Harmonisation of Transactions Avoidance Laws, Intersentia, 2022.

improving cross-border insolvency law."[4] But what is a principle-based approach? Essentially, it boils down to a legal analysis based on a taxonomy of relevant and widely-accepted standards. It entails a study of rules (i.e. positive law), their assessment through the lens of legal principles with the purpose of developing optimal policy choices.

There are multiple benefits of using the principle-based approach. Legal principles represent broad standards and core values behind practice and behaviour. Better understanding these values is crucial to grasp the essence of law, which is key to better interpretation and application of legal rules. The principle-based approach can also facilitate change and harmonisation efforts, because it helps to find principle-based solutions to similar problems experienced by various legal systems. Finally, clarity of legal principles allows a deliberate and well-informed balancing exercise to solve conflicts between legal principles.

The choice of the principle-based methodology in this book is premised on the realisation that financial distress within international enterprise groups gives rise to complex legal and financial issues, which are not always possible and easy to conceptualise or codify into rigid rules. Going back to the legal principles is one way to deal with this complexity. However, any study of law benefits from the use of different research methods. Considering this book's subject – intra-group financing and insolvency within enterprise groups, often driven by economic considerations – incursions into law and economics are inevitable. This is why some chapters of this book will use economic insights when analysing group relationships, problems and potential solutions. This analysis is not meant to be full or comprehensive. After all, the goal of economic efficiency that underpins law and economics scholarship may need to give way to the rationale of legal coherence, seen as a unifying or internal structure of law.[5] In addition to preserving coherence, law may be driven by the pursuit of goals other than economic ones.[6]

---

4 B. Wessels, Book Bork on Cross Border Insolvency Law, 2 October 2017 <https://bob-wessels.nl/blog/2017-10-doc1-book-bork-on-cross-border-insolvency-law/> (accessed 3 December 2022).

5 E.J. Weinrib, The Idea of Private Law, OUP, 2012, p. 30, noting that "coherence points to the existence of some sort of internal connection between the various features that cohere."

6 A. Keay, Insolvency Law: A Matter of Public Interest? Northern Ireland Legal Quarterly, Vol. 51, 2000, pp. 509-534; E. Warren, Bankruptcy Policymaking in an Imperfect World, Michigan Law Review, Vol. 92, 1993, p. 355, arguing that insolvency policy should give consideration to the distributional impact of business failures on parties who are not creditors. Paterson describes the debate among scholars adopting an economic approach to corporate reorganisation law and scholars adopting a progressive approach, as a "debate about the ways in which a capitalist economy promotes public interest and social welfare." S. Paterson, Corporate Reorganization Law and Forces of Change, OUP, 2020, p. 2.

The chapter proceeds as follows. Section 4.2. deals with an unavoidable issue of definitions. Section 4.3. identifies those legal principles which are of the highest relevance for our analysis. Section 4.4. explores how the legal principles apply in a group insolvency setting. Section 4.5. concludes.

4.2 Defining a Legal Principle

Law is connected to fundamental societal values by way of legal principles. These principles express certain basic standards and constitute the normative core of a legal system. There are continuous academic debates about the definition of a legal principle, its true meaning, content and nature.

According to Dworkin, a major proponent of the principle-based theory of law, a "principle" is a "standard that is to be observed, not because it will advance or secure an economic, political or social situation deemed desirable, but because it is a requirement of justice or fairness or some other dimension of morality."[7] Yet the notions of justice and fairness are themselves difficult to grasp. They also tend to depend on specific context, historical and cultural factors and individual perceptions. This is not to say that the formation of legal principles is free from the influences of prevailing moral and social customs and practices. However, the principles discussed in this book are primarily derived from rules and regulations rather than solely from the dimension of morality.

For Alexy, legal principles are optimisation commands or requirements (*Optimierungsgebot*), which signal or dictate that something should "be realized to the greatest extent possible given the legal and factual possibilities."[8] This forward-looking character of principles was highlighted by Ávila, who argues that "principles" are "immediately finalistic, primarily future regarding norms which intend to be complementary and partial, whose application requires assessing the correlation between the state of affairs to be promoted and the effects of the conduct seen as necessary to its advancement."[9] Thus, legal principles set forth valuation guidelines which should be followed in order to achieve an ideal state of affairs. But they fall short of describing the exact behaviour needed to accomplish the goals.

---

7 R.M. Dworkin, The Model of Rules, The University of Chicago Law Review, Vol. 35, 1967, p. 23. For criticism of the Dworkin's theory of principles, see L. Alexander, K. Kress, Against Legal Principles, Iowa Law Review, Vol. 82, 1997, p. 745, arguing that "principles that fit the legal rules and that are assessed for moral attractiveness are not themselves moral principles." In other words, Alexander and Kress assert that legal principles arise from the body of posited, canonical legal rules, which does not mean that they are the morally best principles.

8 R. Alexy, A Theory of Constitutional Rights, OUP, 2010, p. 47.

9 H. Ávila, Theory of Legal Principles, Springer, 2007, p. 40.

Instead, they complement decision-making, and their realisation depends on a specific situation, as well as the existence of other principles at play.

The difficulty of offering a universal definition of a "legal principle" is evident from an overview of documents produced by the standard-setting organisations. For example, the World Bank Principles for Effective Insolvency and Creditor/Debtor Regimes (World Bank Principles)[10] and INSOL International's Statement of Principles for a Global Approach to Multi-Creditor Workouts II[11] describe principles as the "distillation of international best practice" and "statements of best practice" respectively. In the ALI/III Global Principles for Cooperation in International Insolvency Cases,[12] principles are mentioned alongside "core values". Other documents not directly or solely related to insolvency, such as the Principles of European Contract Law[13] and the UNIDROIT Principles of International Commercial Contracts,[14] equate principles to "general rules". The Draft Common Frame of Reference follows the above instruments in considering principles as rules of "a more general nature, such as those of freedom of contract and good faith."[15]

Treating legal principles as fundamental rules, norms,[16] meta-norms,[17] important topics and statements of best practices is confusing and does not clarify the meaning of a principle for the purposes of this study. Much more useful is the distinction between legal principles and legal rules. According

10 The World Bank, Principles for Effective Insolvency and Creditor/debtor Regimes, 2021.

11 INSOL International, Statement of Principles for a Global Approach to Multi-Creditor Workouts II, 2nd edn, 2017.

12 ALI/III Transnational Insolvency: Global Principles for Cooperation in International Insolvency Cases, 2012.

13 The Principles of European Contract Law (PECL), Article 1:101(1): "These Principles are intended to be applied as general rules of contract law in the European Communities."

14 UNIDROIT Principles of International Commercial Contracts (UPICC), 2016, Preamble: "These Principles set forth general rules for international commercial contracts."

15 C. von Bar et al. (eds), Principles, Definitions and Model Rules of European Private Law. Draft Common Frame of Reference (DCFR), Outline Edition, Sellier, 2009, p. 9.

16 Raz refers to legal principles and legal rules as "general legal norms" since both of them guide human behaviour by proscribing a certain course of action. J. Raz, Legal Principles and the Limits of Law, The Yale Law Journal, Vol. 81, 1972, pp. 823-854. Schauer writes that "in the contemporary conception of norms, norms are the prescriptive rules […] about human behavior that are not written down in canonical form, but which arise largely from our social existence." F. Schauer, The Force of Law, HUP, 2015, p. 140. Schauer distinguishes these social norms from legal norms, which are supported by "the force of law".

17 J.A.E. Pottow, Greed and Pride in International Bankruptcy: The Problems of and Proposed Solutions to 'Local Interests', Michigan Law Review, Vol. 104, 2006, p. 1929, defining a meta-norm as a "a norm that is a step removed from the baseline content of a specific statutory provision." Pottow provides an example of "employee protection" as a bankruptcy meta-norm.

to Dworkin, rules apply in an all-or-nothing fashion.[18] Thus, if the conditions for the application of a rule are satisfied, this rule must be followed (if → then). If there is a conflict between the rules, one of them ought to be considered invalid, unless an exception to the rule applies. Unlike rules, principles have a higher level of abstraction and often do not prescribe a particular course of action or conditions that make their application necessary.[19] Ávila notes that rules are distinct from principles to the extent that they constitute "immediate descriptive norms" and contain obligations, permissions and prohibitions.[20] Alexy emphasises that unlike rules, principles are not definitive but only *prima facie* requirements or reasons that can be displaced by other *prima facie* reasons.[21]

Consider the following example of a provision in the law containing a rule, backed by a specific legal principle or principles. Article 372(3) of the Dutch Bankruptcy Act permits the debtor to submit a request to the court and ask for a stay (cooling-off period) for the benefit of third parties – group guarantors, collateral providers or co-debtors. This rule is underpinned by the principle of procedural efficiency – third parties do not need to file separately to benefit from a stay. As a result of this extended stay, creditors cannot enforce claims against group entities and thereby destroy group synergies and disrupt restructuring efforts. Thus, there are at least two principles behind the rule: procedural efficiency and estate value preservation and maximisation. Another example is § 365(e) of the US Bankruptcy Code. Under it, ipso facto clauses – provisions in executory contracts and unexpired leases that terminate or modify such contracts upon the commencement of a bankruptcy case are unenforceable. If a clause in an executory contract falls within the scope of this rule (if → then), it has no legal effect. The reason behind an ipso facto ban relates to the fact that ipso facto clauses could hamper rehabilitation efforts and lead to the unnecessary liquidation of economically viable businesses.[22] This rule, therefore, contributes to the principle of value preservation and maximisation.

---

18 R.M. Dworkin, The Model of Rules, The University of Chicago Law Review, Vol. 35, 1967, p. 25.

19 H. Gribnau, Legitimacy of the Judiciary, in E.H. Hondius, C. Joustra (eds), Netherlands Reports to the Sixteenth International Congress of Comparative Law, Intersentia, 2002, pp. 25-45, observing that rules may be seen as "operationalisations of principles", which have more concrete and "technical" character. Gribnau distinguishes rules from principles by pointing out that the former are commands formulated by authorised institutions, while the latter lack the imperative quality but possess normative quality.

20 H. Ávila, Theory of Legal Principles, Springer, 2007, p. 34.

21 R. Alexy, A Theory of Constitutional Rights, OUP, 2010, p. 57.

22 Report of the Committee on the Judiciary together with Separate Supplemental, and Separate Additional Views, H.R. Rep. No. 95-595, 1977, at 348, explaining that the goal of § 365(e)(1) is to restrict the application of clauses that frequently hamper rehabilitation efforts.

In sum, legal principles are distinguished from rules and positive law, more generally, that may or may not reflect a particular legal principle. A rule might contradict a legal principle and may need to be revised or re-interpreted in order to bring it in line with a principle. Legal principles are manifestations of fundamental values in a legal system. They can find their way into a variety of rules, sometimes in different areas of law.[23] Societal and economic background is capable of affecting our understanding of legal principles. It may also cause new principles to appear and substitute or supplement the existing ones. In other words, legal principles develop over time to accommodate different values and views. Yet they are more stable than rules which can be introduced on a whim. The next section discusses the legal principles that are most relevant for this book.

4.3 Core Legal Principles at Play in Insolvency

4.3.1 Classification of legal principles

Bork divides the principles of insolvency law into three broad categories: (i) jurisdictional, (ii) procedural, and (iii) substantive principles.[24] Jurisdictional principles deal with the relationships between sovereign states and include, among others, principles of unity, universalism, mutual trust, communication and cooperation in insolvency cases. Procedural principles relate to the organisation of a procedure, which must comply with the standards of efficiency, transparency, predictability and procedural justice. Many of these principles are not peculiar to insolvency proceedings and apply to a general civil procedure. The third category is substantive principles. These principles are often unique, reflecting the influence of insolvency on the substantive rights and legal position of different parties, including creditors, debtors and shareholders.

Among the substantive principles, Bork mentions: (i) equal treatment of unsecured creditors, (ii) the best possible realisation of debtor's assets (insolvency estate value maximisation), and (iii) protection of legitimate expectations, also referred to as protection of trust. The latter is closely related to the principles of party autonomy and freedom of contract. As such, protection of trust and freedom of contract are not the principles "of" insolvency law, but the principles "relevant for" insolvency law. The book

23 For example, the principle of protection of legitimate expectations and certainty of transactions justifies special treatment of rights *in rem*, both in the context of property, contract and insolvency law. This principle is further evidenced in concrete rules, for instance, in Article 8 of the EIR Recast, which in some cases insulates rights *in rem* from the effects of *lex concursus*.

24 R. Bork, Principles of Cross-Border Insolvency Law, Intersentia, 2017, pp. 16-17.

focuses on these principles in view of their relevance in a group financing and insolvency context. As noted in the introductory chapter, private international law falls outside the book's scope, thereby making jurisdictional principles less relevant for our discussion. The same applies to procedural principles, at least to the extent they do not directly implicate one of the substantive principles.

The selection of principles in this book does not dismiss the importance of other legal principles. On the contrary, their significance must be expressly recognised. One example is the principle of social protection, which often plays a distinct role in structuring and executing corporate and financial restructuring.[25] Yet its relevance to the main subject of this book is not leading. Given the wide range of social standards and policies protecting employment,[26] and specific national variations of such standards, any in-depth and well-deserved analysis of the principle of social protection cannot be undertaken within these pages. Similarly, the application of jurisdictional principles in group insolvencies merits a separate book.

4.3.2 Principles of insolvency law v. principles of restructuring law

One may wonder (and rightly so) whether the principles of insolvency law, listed above, should equally apply to the types of restructuring proceedings that require neither (full) collectivity (Dutch WHOA plans, English schemes of arrangement and Part 26A restructuring plans) nor a set degree of financial distress or, indeed, insolvency (US Chapter 11, English schemes of arrangement). This is an important consideration that becomes more evident as we dive into the comparative analysis of national laws in the subsequent chapters of this book.

The type of procedure cannot be ignored because it affects the scope of available tools. For example, transaction avoidance is not available in English company voluntary arrangements and schemes of arrangement,

25 A. Kastrinou and S. Vullings, 'No Evil is without Good': A Comparative Analysis of Prepack Sales in the UK and the Netherlands, International Insolvency Review, Vol. 27, 2018, pp. 320-339, discussing the effects of the CJEU's ruling in *Estro/Smallstep* on pre-packaged restructurings (pre-packs). Also, Article 369(4) of the Dutch Bankruptcy Act (*Faillissementswet* or Fw), stating that the provisions on WHOA schemes do not apply to rights of employees arising from employment contracts.

26 J.L.L. Gant, Studies of Convergence? Post-Crisis Effects on Corporate Rescue and the Influence of Social Policy: the EU and the USA, International Insolvency Review, Vol. 25, 2016, pp. 72-96, noting strong path dependence in labour law, grounded in different cultural and traditional ideologies. Also J.L.L. Gant, Balancing the Protection of Business and Employment in Insolvency: An Anglo-French Perspective, Eleven International Publishing, 2017.

as well as in Dutch WHOA schemes. Yet transactions can be challenged in a Chapter 11 procedure, English administration, and Dutch bankruptcy procedures. Another example is third-party releases (Chapter 10), which have a statutory basis in the rules on WHOA schemes, but not in the rules concerning bankruptcy and suspension of payments. Given how different these procedures are, can they be subject to the same set of legal principles?

Arguing that the realms of insolvency and restructuring law and the legal principles underpinning them should be separated, Madaus writes that "a restructuring agreement would be the result of restructuring proceedings which do not respond to a common pool problem, but instead aim at facilitating the conclusion of a contract and, thus, are governed by contract (and company) law rules and principles."[27] For Madaus, the said realms are distinguished on the basis of the problem that law aims to solve – a collective action problem (insolvency law) v. anticommons (restructuring law). Bork and Veder also observe that the principles of insolvency law are not applicable "where the proceedings are not dependent on the debtor's insolvency and therefore not collective proceedings."[28] Hence, for Bork and Veder, the realms are separated based on the requirements of "substantive insolvency" and "collectivity".[29] This means that restructuring proceedings used at an early stage of the financial crisis and those not entailing collectivity are not covered by insolvency law and its principles. By contrast, Mevorach and Walters state that "[i]nsolvency and restructuring law is […] a unified body of law that maps onto the continuum, rather than two discrete bodies of law."[30]

Any attempts to strictly delineate insolvency and restructuring laws are problematic for several reasons.

27 S. Madaus, Leaving the Shadows of US Bankruptcy Law: A Proposal to Divide the Realms of Insolvency and Restructuring Law, European Business Organization Law Review, Vol. 19, 2018, p. 630.

28 R. Bork, M. Veder, Harmonisation of Transactions Avoidance Laws, Intersentia, 2022, para. 3.5.

29 Ibid., para. 3.6., defining "substantive insolvency" as "comprising not only present but also likely and imminent inability to pay debts as they fall due […]." Thus, it covers actual insolvency, likely insolvency (inability to pay debts in the foreseeable future with likelihood of >50%) and imminent insolvency (inability to pay debts within the next few months). Note, however, that Bork and Veder discuss substantive insolvency in the context of transaction avoidance law and argue that its application would be difficult to justify in restructuring proceedings for companies "in the state of looming, but not likely imminent or present, inability to pay."

30 I. Mevorach and A. Walters, The Characterization of Pre-insolvency Proceedings in Private International Law, EBOR, Vol. 21, 2021, p. 879.

- First, the same procedure may be used for the collective resolution of financial distress or for targeted debt restructuring (e.g. Dutch WHOA scheme). If we adopt collectivity as a distinguishing criterion, the same procedure can fall under the insolvency or restructuring realm, depending on how it is being used in a concrete case. Besides, a combination of proceedings could be utilised to reach the desired goal. For example, in the UK, schemes and CVAs are often combined with administration. Applying different principles to these interlinked procedures creates unnecessary rigidity.
- Second, financial distress is a fluid concept, reflecting a demise curve or a downward spiral. In practice, looming insolvency can easily turn into a likely insolvency, imminent insolvency, or real insolvency. This is why it is rather difficult and, perhaps, arbitrary, to use the degree of financial distress as a qualifying criterion to determine if we are still dealing with restructuring law principles, or whether insolvency law principles have already kicked in. Think of Chapter 11. Since it does not mandate any degree of financial distress, one cannot determine in the abstract whether it belongs to the realm of insolvency or restructuring law.
- Third, given that group restructuring may be realised via different procedures – whether fully collective and insolvency-driven or not, a broad and open approach is well justified. The framing of law as either restructuring or insolvency does not easily fit this approach.
- Fourth, and finally, the chosen principles appear to be so fundamental and transpiring that they should and, as demonstrated below, do apply in both "traditional" insolvent liquidations and restructuring proceedings.

In sum, the choice of legal principles in this book is not substantially affected by the type of proceeding, as long as such a proceeding seeks to address the debtor's financial distress, wherever it is located on the demise curve.

4.3.3 Value preservation and maximisation

The principle of value preservation and maximisation aims to "facilitate higher distributions to creditors as a whole and reduce the burden of insolvency."[31] Insolvency law is often viewed as a way to resolve creditors' claims in the most efficient way. In principle, this is done through a collec-

31 UNCITRAL Legislative Guide, Part one, Ch. I, para. 5. In practice, however, due to privileges granted to certain groups of creditors, it is often not creditors "as a whole" who benefit from insolvency estate value maximisation, but privileged groups of creditors. See C.G. Paulus, Multinational Enterprises and National Insolvency Laws: Lobbying for Special Privileges, EBOR, Vol. 29, 2018, pp. 393-415.

tive procedure that replaces individual enforcement by creditors. The court supervises the use and disposition of assets and holds them together to preserve and maximise their value.

According to Baird, we need insolvency law "to ensure that the self-interest of individuals does not run counter to the interests of the group."[32] Bork and Veder distinguish the principles of the best possible realisation of debtor's assets (optimisation) and the best possible satisfaction of creditors' claims (satisfaction).[33] The former deals with assets which comprise the insolvency estate at the time of the opening of an insolvency proceeding and strives to secure the highest price for these assets. It does so by, among other things, providing for the termination of onerous contracts and keeping the costs of the proceeding low. The latter addresses any disadvantage caused to the general body of creditors and enriches the insolvency estate by, inter alia, undoing detrimental acts and economically revoking their disadvantageous effects. For simplicity and given how close these principles are – representing different sides of the same coin – this book refers to the unified principle of value preservation and maximisation.

This principle is recognised as a guiding principle of insolvency law by the World Bank,[34] UNCITRAL,[35] the European Bank of Reconstruction and Development,[36] the EU instruments[37] and many national legal systems.[38] The goal of value preservation and maximisation in the insolvency context has two major aspects – procedural and substantive efficiency. The former focuses on minimising the direct and indirect costs associated with insolvency proceedings. These costs include court fees and fees of IPs, but also reputational damage, workforce attrition, reduced access to credit, and unwillingness of third parties to continue trading with a financially

32 D.G. Baird, A World Without Bankruptcy, Law and Contemporary Problems, Vol. 50, 1987, p. 184.

33 R. Bork, M. Veder, Harmonisation of Transactions Avoidance Laws, Intersentia, 2022, paras. 2.43-2.50.

34 The World Bank, Principles for Effective Insolvency and Creditor/debtor Regimes, 2021, C1, mentioning that an effective insolvency system should aim to "[m]aximize the value of a firm's assets and recoveries by creditors."

35 MLCBI, Preamble, listing among is objectives the protection and maximization of the value of the debtor's assets.

36 EBRD Core Principles of an Effective Insolvency System, September 2020, Principle 2, stating that "[i]nsolvency procedures should be designed and implemented to preserve and maximise the total value ultimately available to creditors."

37 Restructuring Directive, Recital 2, noting that, among other policy goals, restructuring frameworks should help to maximise the total value to creditors.

38 L.G.A. Janssen, EU bank resolution framework: A comparative study on the relation with national private law, E.M. Meijers Instituut, 2020, p. 190, noting that in the UK, Germany and the Netherlands, the objective of maximising the returns to creditors is regarded as the primary objective of insolvency law.

distressed or insolvent entity. By some estimates, direct costs of insolvency range between 1% and 10% of the firm value, while indirect costs could reach up to 23%.[39]

The substantive dimension of efficiency underpins an array of mechanisms and tools utilised by insolvency law to preserve the existing value or to maximise it. This can be accomplished by means of transaction avoidance, prohibition of ipso facto clauses and protection of rescue financing. Some of these tools primarily aim to preserve the present value and protect it against losses. For example, a stay on individual enforcement actions, termination of disadvantageous contracts and limitations of contract clauses which could dissipate the value, all seek to keep the current asset base intact. Other tools are used to enlarge this base by, inter alia, holding debtor's directors liable for insolvency-related misbehaviour.[40] To facilitate the analysis in the following chapters of the book, a number of preliminary points should be addressed.

First, insolvency estate value can be established as either the liquidation value or the going concern value. The former represents the value of the debtor's assets if they were to be sold on the market on a piecemeal basis. The latter refers to the net present worth of the business as a going concern, taking into account its operational continuity and future income (going concern surplus)[41]. Westbrook stresses that the "going concern value may be much greater than market value (and therefore, much, much greater than liquidation value) because a living business […] may well bring a higher price as a unit than would the sale of each asset separately."[42] The preservation of the going concern value of the debtor's business may be achieved through restructuring.

---

39 Z. Sautner, V. Vladimirov, Indirect Costs of Financial Distress and Bankruptcy Law: Evidence from Trade Credit and Sales, Review of Finance, Vol. 22, 2018, pp. 1667-1704, arguing that indirect costs can be reduced by increasing the likelihood of out-of-court restructuring.

40 Case C594/14 *Simona Kornhaas v. Thomas Dithmar*, 10 December 2015, para. 20, holding that director liability action in question contributed to the "attainment of an objective which is intrinsically linked, mutatis mutandis, to all insolvency proceedings, namely the prevention of any reduction of the assets of the insolvent estate before the insolvency proceedings are opened."

41 Black's Law Dictionary defines the "going concern value" as the "value of a commercial enterprise's assets or of the enterprise itself as an active business with future earning power, as opposed to the liquidation value of the business or of its assets." Black's Law Dictionary, 8th edn, Thomson Reuters, 2004, p. 1587.

42 J.L. Westbrook, The Control of Wealth in Bankruptcy, Texas Law Review, Vol. 82, 2004, p. 811.

Second, restructuring is often achieved by one of the following methods: (i) postponement of liabilities into more distant future, (ii) conversion of debt into equity, and (iii) debt reduction or write-down.[43] The UNCITRAL Legislative Guide connects the choice between liquidation and reorganisation to the objective of value maximisation.[44] Similarly, the Conference of European Restructuring and Insolvency Law concludes that the "rules which support restructuring efforts conceivably enforce the principle of optimal realisation of the debtor's assets."[45] Restructuring can also contribute to the accomplishment of other goals, such as the prevention of job losses and facilitation of competition. Yet whether restructuring can be seen as a substantive principle in and of itself is debatable. Bork and Veder argue that restructuring "is not a core value in itself, since goals and policies are to be distinguished from principles."[46] We agree.

Third, when comparing rescuing distressed companies and individuals, Judge Conner pointed out that "a corporation is not a biological entity for which it can be presumed that any act which extends its existence is beneficial to it."[47] In order to distinguish which companies could (and should) be restructured to safeguard their value, the concept of economic viability needs to be explained. Viability is a complex concept, which may indicate the competitiveness of the debtor's business model and good prospects for its post-restructuring survival. It also characterises businesses whose going concern value exceeds the hypothetical liquidation value.[48] Economic viability, as contrasted with financial viability (i.e. the ability to pay off debt obligations), is often established as an eligibility threshold or a filtering

43 M. Crystal and R.J. Mokal, The Valuation of Distressed Companies – a Conceptual Framework, International Corporate Rescue, Issues 2 and 3, 2006 <https://ssrn.com/abstract=877155> (accessed 15 July 2023).

44 UNCITRAL Legislative Guide, Part one, Ch. I, para. 6, stating that insolvency law "should include the possibility of reorganization of the debtor as an alternative to liquidation, where creditors would not involuntarily receive less than in liquidation and the value of the debtor to society and to creditors may be maximized by allowing it to continue."

45 CERIL Report 2017-1, 26 September 2017, para. 35.

46 R. Bork, M. Veder, Harmonisation of Transactions Avoidance Laws, Intersentia, 2022, para. 2.46.

47 *In re Investors Funding Corp. of New York Sec. Litig.*, 523 F. Supp. 533, 541 (S.D.N.Y. 1980).

48 L. Tsioli, Viability assessment in corporate debt restructuring: Optimizing the filtration effect of the European directive on restructuring and insolvency, Norton Journal of Bankruptcy Law and Practice, Vol. 30, 2021, p. 400; M. Kahl, Economic Distress, Financial Distress, and Dynamic Liquidation, The Journal of Finance, Vol. 57, 2002, p. 141, arguing that "[v]iable firms should be continued because their continuation value is higher than their liquidation value."

screen for restructuring proceedings.[49] This is based on the assumption that restructuring of non-viable firms can lead to the destruction of value, instead of its preservation.[50]

Fourth, the principle of estate value preservation and maximisation does not touch upon the issue of distribution among creditors. It does not deal with value allocation. Nevertheless, there is an important safeguard connected to it, namely the protection of a certain entitlement baseline. This baseline transpires in the ubiquitous best-interests-of-creditors test, similar to the NCWO test mentioned in Chapter 3.[51] This test sets out a reference point, commonly, the expected distribution in an insolvent liquidation or an alternative scenario.[52] The reference point shields the value of the existing creditors' entitlements, promotes substantive fairness and ensures the protection of property rights. Thus, if a reorganisation plan facilitates business survival and increases the debtor's value but harms creditors' interests, as compared to a baseline (minimum) scenario, such a plan is unlikely to be confirmed unless the affected creditors consent to it. As a general rule, the interests of economic efficiency judged from the perspective of net benefits and costs cannot trump the interests of individual creditors. This signifi-

49 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 the norms on involuntary conversion and dismissal (11 U.S. Code § 1112) and relief from the stay (11 U.S. Code § 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. Insolvency Act 1986, Part A1, A(1)(e). See also StaRUG, § 14, stating that a "restructuring plan is to be accompanied by a substantiated declaration concerning the prospects for eliminating the debtor's imminent illiquidity through the plan and for ensuring or restoring the debtor's viability." For Dutch law, see Rb. Den Haag 2 March 2021, ECLI:NL:RBDHA:2021:1798, noting that the rules introduced by the WHOA primarily focus on companies which are in danger of becoming insolvent due to over-indebtedness, but have businesses that are still viable. The court accepted that it is primarily up to the creditors to form an opinion on the viability of the debtor's business. Yet it found itself competent to determine that the business would not be viable post-restructuring. As a result, the WHOA plan was not approved.

50 H. Eidenmüller, Contracting for a European Insolvency Regime, EBOR, Vol. 18, 2017, p. 288, emphasising 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 restructure] are surely not trivial."

51 11 U.S. Code § 1129(a)(7). On the US origins of this principle, see C.J. Tabb, The History of the Bankruptcy Laws in the United States, ABI Law Review, Vol. 3(1), 1995, pp. 5-51. This test manifests itself in national laws of many European jurisdictions. See e.g. InsO, § 251(1); Fw, Article 384(3). It is also mandated by the Restructuring Directive in Recital 52, Article 10(2)(d). The NCWO principle is the fundamental principle governing the protection of creditors' rights in bank resolution. See BRRD, Article 34(1)(g).

52 A. Krohn, Rethinking priority: The dawn of the relative priority rule and the new "best interests of creditors" test in the European Union, International Insolvency Review, Vol. 30, 2021, pp. 75-95.

cant restriction on the utilitarian or majoritarian approach to insolvency is derived from constitutional law.[53]

4.3.4 Protection of legitimate expectations, freedom of contract and party autonomy

Insolvency is a foreseeable risk, as in principle no business is immune from it.[54] It is therefore important that creditors, debtors and other stakeholders are able to calculate ex ante the insolvency-related risks, particularly when engaging in transactions with financially distressed but not yet insolvent debtors.

Virgós and Garcimartín explain that "parties shape their relationships "in the shadow" of a specific legal environment; an environment that includes the degree of "resistance" of [their] rights in the event of the insolvency of the debtor, which is the most typical risk faced by any creditor."[55] When parties enter into agreements, they do so with the expectation that their claims will be fully satisfied. However, in the event of insolvency, this may not be possible. The likelihood and extent of satisfaction depend on many factors, such as the insolvency forum, applicable law (*lex concursus*) and its impact on contractual rights (e.g. permissibility of set-off, termination of executory contracts, enforceability of ipso facto clauses, protection of rights *in rem*, transaction avoidance).

The ability to assess these factors, and therefore respond to them in one way or another, improves risk calculation (where risk is understood as the uncertainty of future returns), creates incentives to engage in financial relationships ex ante, and reduces the costs of insolvency ex post.[56] By contrast,

---

53 S. Madaus, Leaving the Shadows of US Bankruptcy Law: A Proposal to Divide the Realms of Insolvency and Restructuring Law, European Business Organization Law Review, Vol. 19, 2018, p. 638.

54 "Insolvency-proofness" existed in France with reference to establishments of industrial and commercial character (EPICs in their French acronym), such as La Poste. In French administrative law, EPICs are legal entities governed by public law. Yet they have a legal personality distinct from the state. The status of an EPIC entailed certain legal consequences, including inapplicability of insolvency procedures. As a result, creditors of La Poste effectively had an implied and unlimited state guarantee that their unpaid claims would not be cancelled. This immunity, however, was considered to be a source of state aid, triggering specific obligations. Case C-559/12 P, *French Republic v. European Commission*, 3 April 2014. Another example comes from Russia, where the law makes certain types of legal entities completely immune from insolvency. See Russian Civil Code, Article 65.

55 M. Virgós, F. Garcimartín, The European Insolvency Regulation: Law and Practice, Kluwer Law International, 2004, p. 87.

56 J-C. Bricongne, M. Demertzis, P. Pontuch and A. Turrini, Macroeconomic Relevance of Insolvency Frameworks in a High-debt Context: An EU Perspective, European Commission Discussion Paper 32, June 2016.

breach of trust and legitimate expectations result in social costs in the form of foregone transactions (transactions that did not take place due to legal uncertainty), higher interest rates that limit access to credit due to increased costs, extended screening or due diligence expenses, and protracted litigation.

In his analysis of the major principles of international insolvency law, Bork noted that the protection of creditors' expectations and trust "is an important pillar of every legal order and a basic tenet to be enforced under the rule of law."[57] There are two important aspects of this principle.

The first aspect relates to the general protection of property rights. Thus, the violation of legitimate expectations may amount to a breach of the right to property.[58] A challenging task is to evaluate which expectations are legitimate. The European Court of Human Rights (ECtHR) held that a legitimate expectation must be of "a nature more concrete than a mere hope and be based on a legal provision or a legal act such as a judicial decision, bearing on the property interest in question."[59] In the case of *Boyadzhieva and Gloria International Limited Eood v. Bulgaria*,[60] the ECtHR found a violation of the right to property where national law permitted (automatic) invalidation of all transactions concluded within the so called "suspect period", determined as the period after the initial date of insolvency – the date of the debtor's inability to meet its obligations towards creditors. Transactions concluded within the suspect period were subject to avoidance without any proof of bad faith and without any assessment of whether they had adversely affected the insolvency estate or the interests of creditors. In reaching its decision, the court referred to the Bulgarian Parliament, which amended the legislation in question, citing the rule of law concerns and the "foreseeability of business activities and legal transactions", and noting that the risk of indefinitely lengthy "suspect periods" undermined legal certainty. The ECtHR saw no reasons to depart from the national parliament's view that the applicable law did not offer a balanced approach and failed to protect the principle of legal certainty.[61]

---

57 R. Bork, Principles of Cross-Border Insolvency Law, Intersentia, 2018, p. 143.

58 The right to property is guaranteed by Article 1 of Protocol No. 1 to the ECHR. M. Sigron, Legitimate Expectations under Article 1 of Protocol No. 1 to the European Convention on Human Rights, Intersentia, 2014.

59 *Gratzinger and Gratzingerova v. the Czech Republic*, Appl. no. 39794/98, Decision (GC), 10 July 2002, Reports 2002-VII, 399, § 73.

60 *Boyadzhieva and Gloria International Limited Eood v. Bulgaria*, Appl. nos. 41299/09 and 11132/10, Judgment, 5 July 2018, § 44.

61 Ibid., § 46. For case analysis, see I. Kokorin and B. Wessels, annotation: European Court of Human Rights 5 July 2018, no. 41299/09 & 11132/10, *JOR* 2019, 3; 778-790 (*JOR* 2019/64 *Boyadzhieva and Gloria International Limited Eood v. Bulgaria*).

The second related aspect concerns the principle of freedom of contract. According to this principle, parties should be free to choose each other as contractual partners and to determine the terms of their agreement.[62] Generally, the onset of the insolvency process does not alter the entitlements or vested interests created before it.[63] In this respect, the World Bank stresses that the "rights of creditors and the priorities of claims established prior to insolvency proceedings […] should be upheld in an insolvency proceeding *to preserve the legitimate expectations of creditors and encourage greater predictability in commercial relationships*"[64] (emphasis added). However, while freedom of contract takes precedence in contract law, it faces significant limitations under insolvency law. At this point, three remarks should be made.

First, there are ways to contractually affect the insolvency process and, to one extent or another, determine its outcome. For example, secured creditors derive their priority and power from pre-insolvency contractual relationships, which guarantee a preferential position in insolvency or the ability to exercise significant control over the insolvency process. In some jurisdictions (e.g. the Netherlands), secured creditors are essentially immune from bankruptcy proceedings. In others (e.g. in the USA), they do not enjoy such immunity, but they typically lead bankruptcy proceedings and dictate the conditions of the business sale.[65] Another example is intercreditor agreements or agreements between creditor(s) and a debtor. These agreements could entail claim subordination, where one creditor or a group of creditors agree to subordinate their rights in insolvency, effectively contracting out of the *pari passu* principle.[66] A new form of insolvency-related contracting are restructuring support agreements, used primarily in the

62 E. McKendrick, Contract Law: Text, Cases, and Materials, 6th edn, OUP, 2014, p. 13. Freedom of contract is not absolute and there are many exceptions imposed to protect weaker parties, ensure competition and fairness. M.J. Trebilcock, The Limits of Freedom of Contract, Harvard University Press, 1997; P.S. Davies and M. Raczynska (eds), Contents of Commercial Contracts: Terms Affecting Freedoms, Hart Publishing, 2020; R.A. Epstein, Contracts Small and Contracts Large: Contract Law through the Lens of Laissez-Faire, in F.H. Buckley (ed), The Fall and Rise of Freedom of Contract, Duke University Press, 1999, p. 28, distinguishing three interrelated concepts: security of exchange, sanctity of contract and freedom of contract.

63 M. Veder, Party Autonomy and Insolvency Law, in R. Westrik and J. van der Weide (eds), Party Autonomy in International Property Law, Sellier European Law Publishers, 2011, p. 261.

64 The World Bank, Principles for Effective Insolvency and Creditor/debtor Regimes, 2021, C12.1.

65 It is noted that without consent from a secured creditor, it may not be possible to sell property in a 363 sale free and clear of liens. C. Mallon, S.Y. Waisman and R.C. Schrock (eds), The Law and Practice of Restructuring in the UK and US, OUP, 2011, para. 2.21.

66 R. Goode, Principles of Corporate Insolvency Law, 4th edn, Sweet and Maxwell, 2011, p. 241; V. Finch and D. Milman, Corporate Insolvency Law: Perspectives and Principles, 3rd edn, CUP, 2017, p. 530.

USA to lock up contractual arrangements and support a particular plan to be later implemented via a pre-packaged deal. These arrangements provide certainty and facilitate "a clearer, quicker, and more reliable path toward exit from Chapter 11."[67] The rise of contractual "regulation" in insolvency led Skeel and Triantis to conclude that US bankruptcy law is considerably less mandatory than it appears to be and that a new contract paradigm seems to be emerging, even if somewhat inconsistently.[68]

Second, not all expectations are to be protected, but only legitimate ones. Ávila points out that the "application of the legal certainty principle requires a link to a *legal reality*, or in simpler language it presupposes a comparison between one norm (the legal certainty principle itself) and another norm (which may be legal, administrative or judicial)"[69] (original emphasis). According to Ávila, "legitimate trust is protected only when there is a sound basis for such trust, perceived as state manifestations so unequivocal as to create expectations."[70] Ávila also asserts that without trust in the legal system, individuals cannot exercise "the right to free self-determination and a decent life."[71]

The legitimate expectations and trust in the stability of legal relations are created by the existing legal rules and their judicial interpretation.[72] If law restricts contractual freedom in the context of insolvency, parties should be able to take this into account when entering into a transaction and calculating their risks. In order to protect parties' expectations, law must be predictable, foreseeable, clear and uniform. In other words, while expectations are "fluid" and change over time under the influence of legal developments, the law itself must possess the elements of stability, foreseeability and clarity. Therefore, the discussed principle does not support the claim that a legal position, once agreed, is set in stone and is absolute. It is not the rationale

67 D.G. Baird, Bankruptcy's Quiet Revolution, American Bankruptcy Law Journal, Vol. 91, 2017, p. 604.

68 D.A. Skeel and G. Triantis, Bankruptcy's Uneasy Shift to a Contract Paradigm, University of Pennsylvania Law Review, Vol. 166, 2018, pp. 1777-1818. The increase in the ability of "creditors in possession" to influence the conduct of business prior and during a Chapter 11 was noted by Rasmussen, who mentions several instruments of control, including covenants in credit agreements, loan-to-own strategies, appointment of a chief restructuring officer, debtor in possession financing, plan support and restructuring support agreements. See R.K. Rasmussen, Taking Control Rights Seriously, University of Pennsylvania Law Review, Vol. 166, 2018, pp. 1749-1776.

69 H. Ávila, Certainty in Law, Springer, 2016, p. 65.

70 Ibid., p. 153.

71 Ibid., p. 183.

72 R. Bork, M. Veder, Harmonisation of Transactions Avoidance Laws, Intersentia, 2022, para. 2.54, observing that "where people trust in the stability of their legal position, they do so in the context of a wider regime of the applicable law, which can include rules weakening their legal position under certain conditions […]."

of the legitimate expectations argument to grant immunity from insolvency, but to ensure that reasonable contracting parties can assess and calculate the risks of counterparty's insolvency prior to entering into relations with it. This can be done if the reliability, stability and calculability of rules, certainty of law and through law, are guaranteed in the legal system.

Third, the issue of legitimate expectations and their protection should be distinguished from party autonomy – a fundamental principle of private law. Party autonomy and its operation in insolvency are the topics of spirited academic debates with no signs of emerging consensus.[73] Whereas legal certainty relates to the foreseeability, predictability and accessibility of legal rules, autonomy speaks to the boundaries of such rules in the first place. Autonomy, as a right to control one's own future, is linked to dignity.[74] A contract is an instrument of party autonomy. The virtue of party autonomy, viewed as an extension of individual autonomy, does not mean that parties' ability to bargain must be unlimited. Indeed, measures to protect public interest,[75] weaker parties (e.g. consumers) and third parties (e.g. creditors) influence the scope of party autonomy and impact ex ante choices.

One example where party autonomy is curbed is the rules on insolvency-related transaction avoidance. Due to the collective nature of insolvency proceedings and the role played by the principles of equal treatment of creditors and estate value maximisation, some otherwise valid transactions become void or voidable. And yet transaction avoidance rules and other rules leading to a collapse, subordination or re-characterisation of a transaction limit a debtor's ability and its counterparty's willingness to enter into a transaction in the first place. They can discourage value-creating transactions.[76] Another example of a collision between freedom of contract and principles of insolvency law is the invalidation or "deactivation" of

73 S.L. Schwarcz, Rethinking Freedom of Contract: A Bankruptcy Paradigm, Texas Law Review, Vol. 77, 1999, pp. 515-604, arguing that the fundamental policies underlying the US Bankruptcy Code, including equality of distribution among creditors and debtor rehabilitation should in certain cases be able to limit contractual freedom. See also J.L. Westbrook, Commercial Law and the Public Interest, Penn State Journal of Law and International Affairs, Vol. 4, 2015, pp. 445-458, stressing the importance of protecting public interest in insolvency and concluding that the latter cannot be ensured through the reliance on creditors' contracting.

74 J. Raz, The Authority of Law: Essays on Law and Morality, Clarendon Press, 1979, p. 221; H. Ávila, Certainty in Law, Springer, 2016, p. 111, arguing that legal certainty is at the service of individual autonomy and that it is an instrument to realise the value of freedom.

75 M. Haentjens, Party Autonomy, Public Policy and European Bank Insolvency Law, Hazelhoff Research Paper Series No. 7, 2015, p. 11, arguing that public interest and welfare maximisation should be balanced against party autonomy.

76 S.L. Schwarcz, Collapsing Corporate Structures: Resolving the Tension Between Form and Substance, The Business Lawyer, Vol. 60, 2004, p. 110, noting that "[w]hen economically beneficial transactions are prevented, all parties suffer."

certain contractual provisions, such as ipso facto clauses. Indeed, a debtor and a creditor may bargain ex ante in view of the applicable law, restricting ipso facto clauses. However, this does not mean that any encroachment on party autonomy is in itself desirable or justifiable, given the importance of respecting commercial bargains and ensuring freedom of contract. Unless there are negative externalities or other convincing reasons, law should strive to interfere with parties' freely made choices as little as possible. And even then, any interference must be proportionate.

4.3.5 Equal treatment of creditors

The principle of equal treatment of creditors means that similarly situated creditors (creditors of the same rank) are to be treated similarly or identically, both in terms of their procedural and substantive rights.[77] The principle goes by different names. For example, it is referred to as *pari passu* (from Latin "on equal footing") or *par est condicio omnium creditorum* (from Latin "the condition of all creditors is equal"). The emphasis is often placed on the pro-rata or rateable distribution of the realised assets within the same creditor class.[78] On an abstract level, the principle of equal treatment of creditors rests on the idea of equality, a sense of fairness,[79] distributive justice and an aversion to inequity, present in many cooperative animals, most notably in humans.[80]

---

77 R. Bork, Corporate Insolvency Law. A Comparative Textbook, Intersentia, 2020, p. 8.

78 K. Akintola, Creditor Treatment in Corporate Insolvency Law, Edward Elgar Publishing, 2020, paras. 3.29-3.30.

79 R. Dworkin, Taking Rights Seriously, HUP, 1977, p. 180, describing a right to equality as "a right to equal concern and respect." Keay and Walton observe that the "underlying aim behind the use of the equality principle is to produce fairness, so that every creditor is treated in the same way." A. Keay and P. Walton, The Preferential Debts' Regime in Liquidation Law: In the Public Interest? Company Financial and Insolvency Law Review, Vol. 3, 1999, pp. 93-94.

80 M. Tomasello, A. Vaish, Origins of Human Cooperation and Morality, Annual Review of Psychology, Vol. 64, 2013, p. 243, noting that children of 5 to 6 years of age show a greater sense of equality and fairness, but also that 3-year-old children tend to divide rewards equitably if they obtained the rewards by working collaboratively. S.F. Brosnan and F.B.M. de Waal, Evolution of responses to (un)fairness, Science, Vol. 346, 2014, pp. 314-321, arguing that some non-human species, such as apes, not only passively or actively protest against receiving less for the same task, but also seek to equalise the outcomes to their own detriment. According to the authors, the latter most likely "reflects an attempt to forestall partner dissatisfaction with obtained outcomes and its negative impact on future cooperation."

Equal treatment of creditors is considered to be a "centrepiece of insolvency law",[81] where the *pari passu* principle is closely related to the collective enforcement regime. This collectivism can help reduce strategic costs, maintain the status quo, and facilitate a proportionate distribution of value among creditors.[82] However, while collectivity is instrumental in securing equality in the treatment of creditors and in resolving the common pool problem, it is not a pre-requisite to its realisation. This is evident in laws that do not require full collectivity.[83] For example, under the Dutch WHOA, the court shall deny a request to confirm a plan if "the plan was procured by deception, *by favouring one or more creditors* or shareholders with voting rights or by other unfair means"[84] (emphasis added). The Restructuring Directive also stipulates that one of the conditions for the approval of a restructuring plan is that creditors with sufficient commonality of interest in the same class are treated equally and in a way proportionate to their claims.[85] The principle of equal treatment of creditors can be found in national law,[86] EU legislation[87] and soft law instruments.[88]

Some level of detail should be provided on the operation of the *pari passu* principle. In the EU, where equality before the law is considered to be a general principle of EU law, this principle is interpreted to mean that "comparable situations should not be treated differently and that different situations should not be treated in the same way, unless such different treatment is objectively justified."[89] This formulation is reminiscent of the idea of formal equality (as opposed to substantive, universal or moral equality),

81 CERIL Report 2017-1, 26 September 2017, para. 14; R. Goode, Principles of Corporate Insolvency Law, 3rd edn, Sweet & Maxwell, 2005, p. 175; R. Bork and M. Veder, Harmonisation of Transactions Avoidance Laws, Intersentia, 2022, para. 2.38.

82 T.H. Jackson, The Logic and Limits of Bankruptcy Law, Harvard University Press, 1986, pp. 16-17, viewing the role of insolvency law as one of "ameliorating a common pool problem created by a system of individual creditor remedies." L.C. Ho, Goode's Swan Song to Corporate Insolvency Law, European Business Law Review, Vol. 17, 2006, p. 1737, arguing that the *pari passu* principle does not underpin collectivity and that maintaining the status quo is not meant to preserve any particular level of priority.

83 See e.g. StaRUG, § 10.

84 Dutch Bankruptcy Act, 384(2)(g).

85 Restructuring Directive, Article 10(2)(b).

86 Insolvency Act 1986, section 107 (UK); Code de commerce, Article L643-8 (France); Federal Law "On Insolvency (Bankruptcy)", Article 142(3) (Russia); InsO, §1 (Germany); Bankruptcy Code, § 726(b) (USA).

87 EIR Recast, Article 23(2); BRRD, Recital 13; CIWUD, Recital 12.

88 UNCITRAL Guide on Insolvency Law, Parts one and two, 2004; Key Attributes of Effective Resolution Regimes for Financial Institutions, 2014, para. 5.1; Principles for Effective Insolvency and Creditor/debtor Regimes, 2021, C1.

89 Case C-313/04, *Franz Egenberger*, 11 July 2006, para. 33; Case C101/12, *Herbert Schaible v. Land Baden-Württemberg*, 17 October 2013, para. 76.

phrased by Aristotle as the need to "treat like cases as like."[90] Following this logic, UNCITRAL prescribes equal treatment of "creditors of the same class"[91], while the World Bank promotes "equitable treatment of similarly situated creditors."[92] Bork describes the principle as "equal treatment of (unsecured) creditors belonging to the same class".[93]

This reference to a particular category or class of creditors rather than to all creditors reflects the current insolvency law reality, where creditors are treated in accordance with their priority rankings.[94] Mokal[95] and other scholars[96] have noted the diminished role of the principle in modern insolvency theory and practice. According to them, the erosion of this principle manifests itself in the plethora of priorities established by statutes, as well as other tools, such as set-off, which may create de facto preferences for some creditors. The relativity of the principle is apparent in cases where other conflicting principles or values are at stake. For example, in a recent case of the Dutch WHOA scheme, the court in Rotterdam approved unequal treatment of unsecured creditors. It reasoned that such treatment was justified by considerations of value preservation. It noted that unequal treatment did not harm the interests of the affected creditors because, in the alternative liquidation scenario, they would receive nothing.[97] Thus, inequality was tolerated to the extent that it was necessary to further another principle.

---

90 Aristotle, Nicomachean Ethics, 1131a (translated by H. Rackham), stating that "for if the persons are not equal, they will not have equal shares; it is when equals possess or are allotted unequal shares, or persons not equal equal shares, that quarrels and complaints arise." The crucial question is how to determine equality in the first place. Harari calls the idea that all humans are equal a "myth" or an "imagined order". According to him, we cherish equality not because it is objectively true, but "because believing in it enables us to cooperate effectively and forge a better society." Y.N. Harari, Sapiens: A Brief History of Humankind, McClelland & Stewart, 2014.

91 UNCITRAL Legislative Guide, Part two, Ch. IV, para. 26.

92 The World Bank, Principles for Effective Insolvency and Creditor/debtor Regimes, 2021, C1.

93 R. Bork, Principles of Cross-Border Insolvency Law, Intersentia, 2017, p. 115.

94 US Bankruptcy Code, § 1123(a)(4), stating that "a plan shall provide the same treatment for each claim or interest of a particular class, unless the holder of a particular claim or interest agrees to a less favourable treatment of such particular claim or interest." InsO, § 226 ("[w]ithin each group equal rights shall be extended to all parties concerned. Any differing treatment of the parties in a group is only permitted with the consent of all parties concerned").

95 R.J. Mokal, Priority as Pathology: The *Pari Passu* Myth, Cambridge Law Journal, Vol. 60, 2001, p. 582, arguing that the principle is "less important than it is sometimes made out to be, and does not fulfil any of the functions often attributed to it."

96 D.A. Skeel, The Empty Idea of "Equality of Creditors", University of Pennsylvania Law Review, Vol. 166, 2018, p. 701, analysing US practice and observing that "[b]ankruptcy courts often bless arrangements that give one group of general creditors starkly different treatment than other groups." B. Wessels, Moeten schuldeisers altijd gelijk behandeld worden? Nederlands Juristenblad, 6, 2010, p. 340, explaining that in Dutch law equality is not a hard and fast principle, and that exceptions to it may follow from the considerations of effectiveness (e.g. better pay-offs to creditors), reasonableness and fairness.

97 Rb. Rotterdam, 3 March 2021, ECLI:NL:RBROT:2021:1769, *JOR* 2021/137, m.nt. Tollenaar.

The relative weight of the *pari passu* principle is evident in cases involving financial contracts and financial institutions, especially if financial stability is at stake.[98] For example, in *Private Equity Insurance Group SIA v. Swedbank AS*, the Court of Justice of the EU (CJEU) had to decide whether granting financial collateral takers the right to enforce the collateral despite the commencement of insolvency proceedings in respect of the collateral provider breached the *pari passu* principle. The CJEU acknowledged that the Financial Collateral Directive conferred an advantage on financial collateral in comparison with other types of security falling outside its scope. However, according to the CJEU, the different treatment in question was permissible as based on an objective criterion that related to the legitimate aim of the Directive, namely "to improve the legal certainty and effectiveness of financial collateral in order to provide stability in the financial system."[99]

The departure from the equal treatment of creditors can also be found in the rules governing bank resolution. For example, both the BRRD and the SRMR provide that certain categories of creditors (e.g. covered deposits, employees, commercial or trade creditors providing critical services) are excluded from the application of bail-in (i.e. write-down or conversion powers).[100] Resolution authorities may also exempt other liabilities from bail-in, where such an exemption "is strictly necessary and is proportionate to achieve the continuity of critical functions and core business lines" or when it is needed to prevent widespread contagion.[101] Clearly, in these cases, the principle of equal treatment is superseded by other principles, including the protection of public interest. As a result, in certain circumstances, even similarly situated creditors may be treated differently in bank resolution.[102]

Without entering into the debate about the "viability" or relevance of the principle of equal treatment of creditors in the modern insolvency law theory, it suffices to say that the equality of creditors is relative, rather than

98 For criticism of this special treatment, see C.G. Paulus, The Wonderful World of Privileges – The Par Condicio Creditorum vs. Closeout-Netting, ECFR, Vol. 11, 2014, pp. 531-553.

99 Case C-156/15, *'Private Equity Insurance Group' SIA v 'Swedbank' AS*, 10 November 2016, para. 51.

100 BRRD, Article 44(2); SRMR, Article 27(3). While interbank short-term liabilities are generally excluded from bail-in, this exclusion does not apply to intra-group situations, so that intra-group short-term liabilities may be subject to bail-in ("liabilities to institutions, excluding entities that are part of the same group").

101 BRRD, Article 44(3); SRMR, Article 27(5).

102 BRRD, Recital 13. M. Schillig, Resolution and Insolvency of Banks and Financial Institutions, OUP, 2016, para. 11.16. Different treatment of creditors in the same class is also allowed under the Key Attributes, para. 5.1, noting that the departure from the general principle of equal treatment of creditors of the same class may be permitted, "if necessary to maximise the value for creditors […] or to minimise the potential systemic impact of a firm's failure."

absolute. At the same time, once the similarity of their position has been determined, the principle is stronger and requires a compelling reason or competing principle to override it.

4.4 Application of Legal Principles in Group Insolvencies

4.4.1 Value preservation and maximisation within enterprise groups

The previous section focused on legal principles, which have, for the most part, been developed and applied in the context of a single-debtor insolvency. One may inquire whether the same principles are relevant in a case where several companies comprising an enterprise group are financially distressed or insolvent. We argue that there are no compelling reasons for such principles to lose their salience. However, the realisation of these principles might require certain re-adjustments. It needs to be more group-mindful or group-sensitive.[103] For example, in economically integrated and interdependent groups, where legally separate entities act as a single enterprise, preservation and maximisation of estate value may necessitate a group-wide strategy. A failure of one group member can be contagious and lead to a domino-like fall of other group members, resulting in a piecemeal sale of assets, suboptimal returns to creditors and liquidation of a viable but distressed business.

Imagine the following (rather typical) scenario of a group that consists of legal entities playing different roles: (i) a company issuing debt instruments and lending the received funds to other group members (FinCo), (ii) a company managing and owning assets essential for the group's business, including intellectual property, licenses, know how, real estate (SPV), (iii) a company exercising managerial control over the entire group and acting as a group treasury through the operation of a centralised cash management system (HoldCo), and (iv) operational companies offering services or manufacturing products in different countries (OpCos). Administering such companies separately in insolvency can be difficult and suboptimal in terms of maximising the insolvency estate value, as the entity-by-entity treatment could trigger a breakup of intra-group links and cut the access to vital resources and lifelines.

103 I. Mevorach, Enterprise Groups in Insolvency: Recent International Developments, in J. Sarra (ed), Annual Review of Insolvency Law, Toronto: Carswell, 2013, p. 285, noting that the promotion of insolvency law goals, such as wealth maximisation and equitable treatment of creditors "may require treating the group as the relevant body or acknowledging inter-connections among group members."

This scenario materialised in the insolvency of the Lehman Brothers group (section 1.1.1.). When the parent company (LBHI) filed for bankruptcy, many of its subsidiaries lost access to valuable sources of finance and information.[104] The corporate legal shields separating the legal entities in the group did not prevent their failure. At least one of the reasons was that behind these shields, the entities (the "empire of subsidiaries") were tied together in a web of debt and cross-guarantees.[105] They depended on each other for the provision of financing, debt refinancing and services. As an example, information on accounts and trades related to group companies was frequently concentrated in one jurisdiction. Thus, LBHI's UK subsidiary, LBIE, recorded data on financial notes relevant to other group entities, including its Dutch subsidiary, LBT. When the latter went bankrupt in the Netherlands, the trustees needed this information to make asset distribution in the Dutch proceedings.[106] After intense negotiations, Dutch IPs obtained an important part of LBT's records from LBIE. A similar case can be imagined if in insolvency group entities lose their access to assets held by other entities in the group, including patents, licenses and customer databases. As a result, operational activity might be paralysed, and the group entities may end up in a piecemeal liquidation.

A well-known example illustrating the importance of a group-wide strategy is the insolvency of KPN Qwest. KPN Qwest was a telecom group that owned and operated rings of fibre-optic cable around Europe and the USA.

---

104 Lehman Brothers Holdings Inc. Chapter 11 Proceedings Examiner's Report (Valukas Report), 2010, p. 1550, describing the Lehman Brothers' centralised intra-group cash pooling system. O. McDonald, Lehman Brothers: A crisis of value, Manchester University Press, 2015, p. 117, explaining the practical issues as each subsidiary was cut off from the others and LBHI, so that "[i]t was not possible to generate information and liquidate assets efficiently and identify ways to maximize value." Just how complex the situation was can be derived from the words of the late Lehman's lawyer Harvey Miller, who reported that "[a]ll the accumulated information in Lehman's systems totals 2,000 terabytes of data, an amount that would completely fill 20,000 computers to the maximum. This vast sea of information spreads across 2,700 software systems applications and is dispersed throughout ledger accounts in the numerous subsidiaries […]. The financial information must be retrieved […] and collated and cross-referenced for accuracy and consistency." See Testimony of Harvey R. Miller before the Subcommittee on Commercial and Administrative Law of the House of Representatives Committee of the Judiciary, 111th Congress, 1st Session for Hearings on "Too Big to Fail: The Role of Bankruptcy and Antitrust Law in Financial Regulatory Reform", 22 October 2009.

105 K. Pistor, The Code of Capital: How the Law Creates Wealth and Inequality, Princeton University Press, 2019, p. 51; J.A. Kirshner, International Bankruptcy: The Challenge of Insolvency in a Global Economy, University of Chicago Press, 2018, p. 5, observing that uncoordinated insolvency proceedings faced the problem of separating intercompany arrangements, representing an elaborate system of cross-collateralisation and intercompany guarantees.

106 F. Verhoeven, Lehman Brothers Treasury, in M. Haentjens and B. Wessels (eds), Research Handbook on Cross-Border Bank Resolution, Edward Elgar Publishing, 2019, p. 349.

Notably, parts of the cable belonged to different group entities – the French part by the French subsidiary, the German part by the German subsidiary, and so on. When the Dutch holding company KPN Qwest N.V. collapsed in 2002, its subsidiaries were forced to file for insolvency and their assets were sold on a country-by-country basis.[107] This result was suboptimal as the value of the ring was much higher compared to the value of its isolated parts. The opposite outcome was reached in the case of Nortel Networks (section 1.1.2.). As a result of a commercially sensible solution to pool the assets of the group and realise them on a global scale, which was possible due to successful cooperation between parallel proceedings running in Canada, the United States and Europe, Nortel's assets were sold for USD 7.3 billion. This amount was significantly larger than could have been expected in a piecemeal local liquidation of licenses and intellectual property rights.

4.4.2 Legitimate expectations and group reality

Legitimate expectations do not exist in a vacuum. They are shaped by the existing factual and legal reality. Therefore, the group reality and the rules adopted to deal with group insolvencies play a role in the formation of parties' expectations. The exact substance of these expectations may vary depending on the totality of facts and circumstances. Several relevant factors come into play, such as the group's business (operational) integration and interconnectedness, the intensity of intra-group financial arrangements and financial integration, the role of the debtor company within the group, past experiences and assurances (e.g. on continued intra-group support), as well as the type and sophistication of creditors themselves (e.g. qualified investors, credit institutions and other professional financiers vs. micro, small and medium-sized enterprises (MSMEs) trade creditors and tort victims). In the case of an integrated enterprise group, the adoption of a group-wide insolvency or turnaround strategy – as opposed to a "singular" entity-by-entity approach – may align with the expectations of creditors who could view the group as a single enterprise. This impression can be supported by the use of the same brand, endorsements of transactions by other members of the group, the filing of consolidated financial statements[108] and the prevalence of intra-group financing.

---

107 N.H. Cooper, Insolvency proceedings in case of groups of companies: prospects of harmonisation at EU level, Briefing Note, 2011, p. 7; Commission Staff Working Document, Impact Assessment accompanying the document Revision of Regulation (EC) No 1346/2000 on insolvency proceedings, SWD/2012/0416 final.

108 S. Pepels, Defining groups of companies under the European Insolvency Regulation (recast): On the scope of EU group insolvency law, International Insolvency Review, Vol. 30, 2021, p. 108, noting the inclusion of companies in consolidated financial statements creates the legitimised expectation that such companies are doing business as a group.

It may be argued that the more centralised and integrated the group is, and as long as this fact is ascertainable by the relevant third parties, the stronger is the argument that a group-sensitive solution should be expected in insolvency. This line of reasoning was articulated by Justice Ramesh (Supreme Court of Singapore), who observed 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."[109] Referring to the fluidity of expectations, he stressed that more frequent incursions into the separate legal personality doctrine may weaken the argument of legitimate expectations when used to justify separate (atomistical) treatment of group companies in insolvency. This point refers to the development of legal doctrine and norms of insolvency law, within which expectations crystallise. If legal rules or their application and interpretation contain group-mindful solutions, creditors should be able to take them into account. When it comes to enterprise group insolvencies, such solutions may refer to issues of international insolvency jurisdiction (e.g. determination of the centre of main interests (COMI)), procedures (e.g. procedural consolidation) and substance (e.g. availability of third-party releases).

The issue of protecting trust and party autonomy usually arises with respect to intra-group transactions and their assessment in the context of transaction avoidance, when a party to a transaction is or becomes insolvent. The question is whether the group reality and indirect group-related benefits should be taken into consideration and to what extent. If the answer is not clear, this is problematic from the perspective of the protection of legitimate expectations and legal certainty. Voidness or voidability of a transaction also has an effect on party autonomy to the extent that, as noted in the preceding section, a contract is one of its key instruments. At this point it suffices to cite UNCITRAL, which adopts the position that "[i]n considering […] intra-group transactions, it will be desirable for the court to be able to take the group context into account […]."[110] The positions taken by UK, US and Dutch law on this issue will be discussed in Chapter 8.

4.4.3 Explicit and hidden priorities in group insolvencies

The principle of equal treatment of creditors may appear to be least affected by enterprise group considerations. Bufford observes that the *pari passu* principle "has a diminished role in the insolvency of an enterprise group (apart from the insolvencies of particular members thereof)."[111] This asser-

109 K. Ramesh, Synthesising Synthetics: Lessons learnt from Collins & Aikman, 2nd Annual GRR Live New York, 26 September 2018.

110 UNCITRAL Legislative Guide, Part three, Ch. II, para. 50.

111 S.L. Bufford, Coordination of Insolvency Cases for International Enterprise Groups: A Proposal, American Bankruptcy Law Journal, Vol. 86, 2012, p. 694.

tion is based on the idea of entity separateness, which results in a separation of insolvency estates and pools of creditors of entities comprising the group. In the absence of substantive consolidation, equal treatment of creditors must be maintained and preserved with respect to each separate group entity. In other words, overarching intra-group creditor equality does not exist. This is why the NCWO and best-interest-of-creditors tests are applied on an entity basis (section 3.5.). Yet there are a few patterns that fine-tune the operation of the *pari passu* principle in a group setting.

The first pattern concerns a special approach to "related" creditors and transactions concluded with them. Insider creditors (e.g. shareholders and group affiliates) may enjoy less protection against transaction avoidance. Besides, in some jurisdictions their claims are subordinated – downgraded in the priority ladder (Chapter 7).

The second pattern is that some creditors can have the same claim against several companies within the group. One of the characteristic features of intra-group financing is the existence of various cross-entity liability arrangements. Among them are cross-guarantees, co-debtorship and collateral arrangements, where at least one other group member acts as a guarantor, co-debtor or a collateral provider for the benefit of another group member. Should the latter be in default, a guaranteed creditor can request performance from that other member, or from both entities simultaneously. As a result, this creditor enjoys covert priority or structural seniority, arising from a combination of entity separateness and its simultaneous perforation by cross-entity liability arrangements. This substantially alters outcomes for non-guaranteed unsecured creditors and elevates the position of the guaranteed creditor.[112] Emphasising the problematic nature of cross-guarantees from an equality perspective, Westbrook submits that "guarantees within a corporate group are a central instrument of priority and obfuscation."[113] This book has two chapters on intercompany guarantees – Chapters 6 and 10.

---

112 A.L. Jonkers, Selective Perforation by Means of Guarantees: Dutch Law, in The 800-Pound Gorilla. Limits to Group Structures and Asset Partitioning in Insolvency, NACIIL 2018 report, Eleven International Publishing, 2019, pp. 81-84, offering examples of how cross-guarantees affect the distribution among unsecured creditors. See W.H. Widen, Corporate Form and Substantive Consolidation, George Washington Law Review, Vol. 75, 2007, p. 240, noting that intragroup guarantees dilute claims for those creditors without guarantees – the phenomenon referred to as the "squeeze down effect".

113 J.L. Westbrook, Transparency in Corporate Groups, Brooklyn Journal of Corporate, Financial & Commercial Law, Vol. 13, 2018, p. 44. Westbrook explains that as a general rule, creditors of the parent company have only indirect claim on the subsidiary's assets. The position of these creditors is therefore subordinate to the creditors of the subsidiary. An upstream guarantee allows a guaranteed creditor to escape structural subordination and compete with non-guaranteed creditors of the subsidiary.

4.5 Conclusion

This chapter lays down a theoretical foundation for the analysis performed in this book. There are various paths one can take to find answers to the questions raised in Chapter 1. One can draw on insights from economic and finance theory to investigate ex ante and ex post effects of the existing or proposed rules. This book takes a different, principle-based approach. It looks at legal principles – understood as fundamental standards, examines how they transpire in concrete rules, and analyses how such rules can be better aligned with these principles. In their operation, universality and relative stability, legal principles are different from positive law with the sea of its constantly changing rules and norms.

The first step is to determine which legal principles are most relevant in light of this book's aims and scope. Following the classification of Bork, three such principles are identified: (i) estate value preservation and maximisation, (ii) protection of parties' legitimate expectations, freedom of contract and party autonomy, and (iii) equal treatment of creditors. The subsequent chapters will demonstrate that these principles frequently underlie insolvency law rules, reinforce and complement each other, or indeed collide with each other, thereby necessitating balancing and leading to various degrees of execution and compromise.

The second step is to establish whether the chosen principles remain relevant and could be relied on in the group insolvency context to the same extent as in a single-debtor scenario. We argue that this is the case and that the core of these principles is unaltered. Yet it is submitted that our understanding of such principles and their pursuit needs to be adjusted to the group legal and economic reality. This reality impacts preservation and maximisation of enterprise value, influences parties' legitimate expectations, guides their behaviour and transactional choices, and further complicates the achievement of the ideal of equal treatment of creditors by creating more room for preferences and unequal treatment.

5 Collision of Legal Principles and How to Resolve it■

5.1 Introduction

The previous chapter not only confirmed the relevance of legal principles to our discussion, but also brought into the spotlight the fact that often different principles apply simultaneously. For example, a bankruptcy stay safeguards debtor's assets in furtherance of the principle of estate value preservation. But it also facilitates equal treatment of creditors to the extent that it ensures that creditors cannot enforce their claims ahead of other similarly situated creditors. These "symbiotic" cases, where legal principles support each other and are aligned with each other, are not controversial. Yet the situation gets complicated if the applicable principles are in conflict. Wood observes that insolvency is "the point at which the law has to make difficult and unavoidable choices between colliding principles."[1] Take, for instance, the avoidance of transactions. Unrestricted application of transaction avoidance rules can enrich the estate, but it would likely be incompatible with the protection of legitimate expectations and certainty of transactions.[2]

The difficult question is what to do if legal principles clash with each other? How should a judge or a legislator weigh and balance conflicting principles? This chapter looks for the answers to these questions. It first discusses whether the idea of fairness, underlying many legal rules, could act as a yardstick to distinguish desirable solutions from undesirable ones (section 5.2.). Having concluded that fairness is context-specific and may be difficult to apply in a measurable and predictable manner, we examine whether legal principles can be distinguished based on a scale of their rela-

---

■ This chapter builds upon the following previously published work by the author:
- I. Kokorin, Insolvency of Significant Non-Financial Enterprises: Lessons from Bank Failures and Bank Resolution, European Business Law Review, Vol. 32, 2021, pp. 521-556.
- I. Kokorin, The Rise of "Group Solution" in Insolvency Law and Bank Resolution, European Business Organization Law Review, Vol. 22, 2021, pp. 781-811.

1 P. Wood, Law and Practice of International Finance, Sweet & Maxwell, 2008, pp. 20-21.

2 R. Bork, M. Veder, Harmonisation of Transactions Avoidance Laws, Intersentia, 2022, paras. 2.106-2-107, noting that the broad application of avoidance powers "would pose a serious threat to the general stability of markets", as it would lead to social costs arising from foregone transactions and elaborate screening. On the flipside, the authors emphasise that "a comprehensive protection of trust is not compatible with the application of other principles", such as the principle of equal treatment of creditors and estate value maximisation.

tive weight, such that some of them prevail over other principles in case of a conflict (section 5.3.). We argue that any distinction based on the weight may result in rigid outcomes and is generally undesirable. It is impossible to prefer one principle in all factual situations. Section 5.4. analyses the meta-principles, including optimisation, consistency, and proportionality. Out of these meta-principles, proportionality is particularly useful in dealing with conflicts between legal principles. Section 5.5. concludes.

5.2 The Notion of Fairness in Insolvency Law

The notion of fairness may be found in many instruments dealing with insolvency law. For example, the UNCITRAL Legislative Guide states that the objectives of insolvency law are "protecting the value of the insolvency estate against diminution […] facilitating administration of those proceedings in a fair and orderly manner".[3] It refers to fairness with regard to the allocation of assets among creditors, the treatment of creditors more generally, transaction avoidance, and continuation of contracts when the debtor is in breach. With a specific focus on group insolvencies, UNCITRAL relies on fairness to substantiate its position on intra-group post-commencement finance, ensuing a "fair apportionment of any harm that arises from […] post-commencement finance".[4] Fairness-related considerations also appear in the context of intra-group transactions and their fairness to creditors, group reorganisation plans and treatment of creditors of different group members, and substantive consolidation. On the latter, UNCITRAL points out that substantive consolidation may lead to "unfairness caused to one creditor group when forced to share *pari passu* with creditors of a less solvent group member".[5] References to fairness can also be encountered in EU law instruments, such as the BRRD[6] and the Restructuring Directive.[7]

Fairness is commonly referenced in national law. For instance, the US Bankruptcy Code stipulates that the court shall confirm a reorganisation plan if the plan "does not discriminate unfairly, and is fair and equitable".[8]

3 UNCITRAL Legislative Guide, Part two, Ch. II, para. 25. Fair administration of insolvency proceedings is mentioned in the Preambles to the MLCBI and MLEGI.

4 UNCITRAL Legislative Guide, Part three, Ch. II, para. 63.

5 Ibid., para. 109.

6 BRRD, Recitals 5 ("fair and predictable" apportion of loss), 51 ("fair and realistic" valuation of assets and liabilities) and 97 (resolution of cross-border groups should follow procedures that "allow for efficient, fair and timely solutions for the group as a whole").

7 Restructuring Directive, Recital 35 (stay should be limited in time to achieve "a fair balance between the rights of the debtor and those of creditors"), Recital 56 (approving derogation from the APR where it is considered "fair").

8 11 U.S. Code § 1129(b)(1). US law does not define "unfair discrimination". The requirement to avoid it is generally interpreted to mean that dissenting classes should receive relatively equal value under the plan as compared with similarly situated classes. R. Olivares-Caminal et al., Debt Restructuring, 2nd edn, OUP, 2016, p. 171.

The Dutch Civil Code mandates that the debtor and creditor shall treat each other in accordance with the requirements of reasonableness and fairness (*redelijkheid en billijkheid*).[9] English courts examine the fairness of any scheme of arrangement at the sanction hearing.[10] Fairness is featured in judgments related to the insolvency of Lehman Brothers, Nortel Networks and Oi Brazil.[11]

The notion of fairness seems to underlie many rules and approaches, distinguishing desirable solutions or outcomes from undesirable ones. Yet a uniform definition of fairness is missing. Indeed, many of the above instruments are silent on what fairness exactly means and whether it holds the same meaning in different contexts. It appears that fairness can refer to the quality of the *procedure* – the fair administration of insolvency proceedings. Procedural fairness is frequently associated with an opportunity to participate in the decision-making process. It is observed that people are more likely to accept decisions if they have participated in making them or were able to share their views, even if the ultimate decision is made by someone else. Therefore, the perceived fairness of the process may influence our perception of the fairness of the outcome – the so called "fair process effect" or "voice effect".[12] This is the reason why, for example, pre-packaged sales, secretly negotiated behind closed door with a group of creditors, are seen as problematic from a fairness standpoint.[13] The unjustifiable exclusion from the decision-making process might result in the refusal of plan

9 Dutch Civil Code, Article 6:2. R.P.J.L. Tjittes, Commercieel contractenrecht, Deel I Totstandkoming en inhoud, Den Haag: Boom Juridisch 2018; Asser/Sieburgh 6-III 2018/391-435. With respect to the WHOA, the Explanatory Memorandum states that the redistribution of reorganisation value under the proposed plan shall not be unfair. MvT, *Kamerstukken II* 2018/19, 35249, noting that a "restructuring plan is unfair if the restructuring value that can be preserved or realised by the plan is not fairly distributed among the creditors and shareholders."

10 J. Payne, Schemes of Arrangement: Theory, Structure and Operation, CUP, 2014, p. 74. Fairness in a scheme context has a specific and limited meaning. See section 3.3.1., noting that the court is not required to form a view of whether the scheme is, in some general sense, or even in the court's own opinion, the "fairest" or "best" scheme.

11 See e.g. *In re Nortel Networks, Inc.,* 532 B.R. 494, 549 (Bankr. D.Del. 2015), noting that "[i]n the absence of an agreement governing allocation or a preponderance of evidence showing entitlement to assets […], the Court's task is to arrive at a fair and equitable mechanism to allocate the billions of dollars of Sales Proceeds to numerous international entities."

12 J. Thibaut, L. Walker, A theory of procedure, *California Law Review*, Vol. *66*, 1978, pp. 541-566; J. Greenberg, R. Folger, Procedural Justice, Participation, and the Fair Process Effect in Groups and Organizations, in P.B. Paulus (ed), Basic Group Process, Springer New York, NY, 1983, pp. 235-256; E.A. Lind, R. Kanfer and P.C. Earley, Voice, Control, and Procedural Justice: Instrumental and Noninstrumental Concerns in Fairness Judgments, Journal of Personality and Social Psychology, Vol. 59, 1990, pp. 952-959.

13 Graham Review into Pre-pack Administration, June 2014; A. Kastrinou and S. Vullings, 'No Evil is Without Good': A Comparative Analysis of Pre-pack Sales in the UK and the Netherlands, International Insolvency Review, Vol. 27, 2018, pp. 320-339.

confirmation.[14] Procedural fairness also emerges in cases involving the recognition of foreign restructuring plans, including those concerning groups of companies.[15]

Alongside procedural fairness, fairness can pertain to the substantive treatment of participants of insolvency proceedings. Whereas the procedural aspect of fairness covers the fairness of the process, substantive fairness deals with the fairness of the outcome – how fair the limited resources are divided among relevant actors. In this respect, Finch asserts that "fairness considers issues of substantive justice and distribution."[16] For Mokal, fairness is about the distribution of rights in the insolvent company's assets.[17] On the matter of distribution, Lixing Sun, professor of behavioural and evolutionary biology, writes that "[t]o be fair, rewards must be proportional to the effort or investment each party contributes to the whole."[18] This is an equity rule, as it does not refer to flat equality. According to Sun, this rule works in the same fashion for the distribution of losses, so that the "party who gets more when things go well should also take more responsibility or punishment when the venture goes awry."[19] Sandel exemplifies this rule when he describes how during the GFC decisions to bail out America's largest banks and other financial firms were perceived by many as unfair, because the "the Wall Street" enjoyed huge profits during the good times but asked for taxpayer money when things turned bad.[20]

---

14 Dutch Bankruptcy Act, Article 384(2); StaRUG, § 63(1); *Sunbird Business Services Ltd, Re* [2020] EWHC 2493 (Ch), declining to sanction a scheme of arrangement and citing concerns related to information requirements – "unequal provision of information to different groups of creditors" and "paucity of information".

15 See e.g. *In re Metcalfe Mansfield Alternative Investments* 421 B.R. 685, 697 (Bankr. S.D.N.Y. 2010), recognising a foreign reorganisation plan and noting that the "key determination required by this Court is whether the procedures used in Canada meet our fundamental standards of fairness."; *In re Vitro, S.A.B. de C.V.*, 473 B.R. 117, 125 (Bankr. N.D.Tex. 2012), also dealing with recognition of a foreign restructuring plan with a third-party release and holding that "[d]eference to a foreign proceeding should not be afforded in a Chapter 15 proceeding where the procedural fairness of the foreign proceeding is in doubt or cannot be cured by the adoption of additional protections."

16 V. Finch, Corporate Insolvency Law: Perspective and Principles, CUP, 2002, p. 50.

17 R.J. Mokal, Corporate Insolvency Law: Theory and Application, OUP, 2005, p. 121. Similarly, Sen points out that fairness reflects the demand "to avoid bias in our evaluations, taking note of the interests and concerns of others as well, and in particular the need to avoid being influenced by our respective vested interests". A. Sen, The Idea of Justice, HUP, 2009, p. 54. This de-biasing characteristic of fairness is noteworthy.

18 L. Sun, The Fairness Instinct: The Robin Hood Mentality and Our Biological Nature, Prometheus Books, 2013, pp. 62-63.

19 Ibid. Sun discusses the "fairness instinct", noting that fairness is a trait we inherit with our genes and explaining that "our natural penchant for cooperation is so ingrained that when we share, donate, and act fairly the brain areas associated with reward and positive reinforcement learning are mobilized."

20 M. Sandel, Justice: What's the Right Thing to Do? 1st edn, Farrar, Straus and Giroux, 2010. For discussion of fairness of bailouts, see E.A. Posner, A. Casey, A Framework for Bailout Regulation, Notre Dame Law Review, Vol. 91, 2015, pp. 479-536.

In insolvency law, the argument of fairness, or of the lack thereof, is often used to advocate for the subordination of shareholder loans.[21] As shareholders benefit from the upside, "capitalizing on the upward potential" (e.g. dividend payment and potentially unlimited increase of share price) when things go well, the argument goes, they should bear the downside risks and be excluded from the competition for the debtor's assets. Thus, equal distribution of assets in insolvency among "insiders" and "outsiders" is portrayed as being unfair, in light of the differences in the ex ante position of these actors. The argument of fairness is also raised in discussions about the treatment of related parties in and outside insolvency,[22] and the practice of intercompany guarantees.[23]

Generally, fairness is connected to the idea of deservingness, which is linked to our understanding of contribution, expectations, risks and rewards, power and influence, as well as the ability to bear the costs of downside or default.[24] The question is whether fairness can serve as a measurement to help us balance conflicting principles. Using the example of shareholder loans, one may wonder if legal systems that subordinate such loans are always fairer compared to those that do not provide for such subordination. Is a legal system that enforces cross-guarantees and permits a strong-form double proof, benefiting sophisticated strongly-adjusting creditors (e.g. banks and bondholders), while trade and tort creditors are deprived of this right, always unfair? And if we (unlikely) arrive at the definitive answers to these questions, what should we do about it and how should we respond to this alleged unfairness?

When discussing fairness, Paterson argues that it "is a slippery concept, which eludes a single definition applicable to all contexts and which suffers from various levels of abstraction unless it is applied to a real situation."[25]

---

21 R.J. de Weijs, Harmonization of European Insolvency Law: Preventing Insolvency Law from Turning against Creditors by Upholding the Debt-Equity Divide, European Company and Financial Law Review, Vol. 2, 2018, pp. 421-422, arguing that it is unfair to allow shareholders to rank above creditors for shareholder loans.

22 J. Dammann, Related Party Transactions and Intragroup Transactions, in L. Enriques and T.H. Tröger (eds), The Law and Finance of Related Party Transactions, CUP, 2019, pp. 218-244.

23 W.H. Widen, Corporate Form and Substantive Consolidation, George Washington Law Review, Vol. 75, 2007, pp. 237-328, discussing the double proof problem and the conflict between the interests of multi-source creditors and single-source creditors from the perspective of fairness. Widen questions the fairness of cross-guarantees and suggests that substantive consolidation may be a solution to restore fairness.

24 E. Warren, Bankruptcy Policy, The University of Chicago Law Review, Vol. 54, 1987, pp. 775-814, mentioning among the features for ordering distributional priorities: (i) relative ability to bear costs of default, (ii) incentive effects of pre-bankruptcy transactions, (iii) similarities among creditors, (iv) owners bear the loss when business fails, and (v) benefits to the bankruptcy estate.

25 S. Paterson, Debt Restructuring and Notions of Fairness, The Modern Law Review, Vol. 80, 2017, p. 600.

Similarly, Mevorach points out that that "the idea of reaching a fair or just result is open ended and suffers from indeterminacy."[26] Paterson and Mevorach seem to agree that the determination of a fair outcome can hardly be carried out in the abstract. It requires taking account of various of factors. For Mevorach, these factors include the ability of a relevant party to respond to insolvency risks ex ante – when transacting with the debtor, and to bear the loss ex post, upon insolvency. For Paterson, normative concerns for fairness differ depending on the context: e.g. SME insolvency, large corporate debt restructuring, and the resolution of financial institutions.

To conclude, fairness is context-specific. What is considered fair in one situation may be seen as manifestly unfair in another situation. Besides, once the case of (perceived) unfairness has been established, it is not evident how a preferred outcome should then be determined.

5.3 Weight of Legal Principles

According to Dworkin, one of the primary characteristics of legal principles is their ability to conflict with each other without negating their validity. He further argues that:

> Principles have […] the dimension of weight or importance. When principles intersect […] one who must resolve the conflict has to take into account the relative weight of each. This cannot be, of course, an exact measurement, and the judgement that a particular principle or policy is more important than another will often be a controversial one. Nevertheless, it is an integral part of the concept of a principle that it has this dimension, that it makes sense to ask how important or how weighty it is.[27]

For Dworkin, the application of principles (and policies based on them) entails a determination of what morality requires.[28] Alexy also recognises that legal principles have a certain weight. He stresses that this weight cannot be determined independently or in absolute terms, or on the basis of morality. Instead, he suggests that it is only possible to speak of the principles' relative weight, assigned to them in some actual circumstances, as a result of the balancing exercise.[29] Ávila adopts a different view and argues that the category of weight is not embodied in legal principles themselves

26 I. Mevorach, Insolvency within Multinational Enterprise Groups, OUP, 2009, p. 118.
27 R. Dworkin, The Model of Rules, The University of Chicago Law Review, Vol. 35, 1967, p. 27.
28 R. Dworkin, Is Democracy Possible Here? Principles for a New Political Debate, Princeton University Press, 2006, p. 27.
29 R. Alexy, The Construction of Constitutional Rights, Law and Ethics of Human Rights, Vol. 4, 2010, pp. 20-32.

but transpires in the reasons and goals to which they refer. It is the latter that a judge must consider when making a decision in each case.[30] Despite this disagreement, it seems that Alexy and Ávila agree that the assignment of weight is case-sensitive and cannot be predetermined.

No conclusive weight can be attached to the legal principles discussed in the previous chapter. It is neither helpful, possible, nor desirable to have a set order or ranking of these principles because none of them appears to be absolute. Barak emphasises that "values do not appear before the judge with a label displaying their weight. Nor is there a list of values organized according to their importance and weight."[31] Just like fairness, the dimension of weight cannot be established in the abstract. It should be assessed and decided upon in a specific case, taking into account the variety of facts and alternatives.

Let us consider a few examples to illustrate this. Imagine a scenario where a group solution (e.g. restructuring plans) is proposed on a centralised basis in a jurisdiction that offers modern restructuring tools and access to financing, and it is the only place where the restructuring can happen.[32] An alternative is a value-destructive liquidation that does not benefit affected creditors but aligns with their expectations regarding the insolvency forum and applicable law. These expectations may be based on the fact that some of the companies within the group have no connection to the jurisdiction where a centralised solution is sought. Should these expectations be respected, or do material and procedural efficiency, and value maximisation prevail? Does it matter if the affected creditors are sophisticated parties, advised by professional advisers and capable of diversifying their risks? What if the restructuring disadvantages some creditors while making the majority of them better off? What if the liquidation creates a serious risk of environmental damage, market instability, or job losses? Does the weighting

30 H. Ávila, Theory of Legal Principles, Springer, 2007, p. 40.

31 A. Barak, The Judge in a Democracy, Princeton University Press, 2006, p. 168.

32 The court's reasoning in the case of Gategroup, an international airline catering services provider, is underpinned by an interplay between the principles of legal certainty and efficiency. To establish jurisdiction for English courts, Gategroup created a UK-incorporated plan company that assumed liability and became a co-obligor. When considering this artificial jurisdictional link, the court acknowledged that "[i]t is possible to imagine uses of the co-obligor structure employed in this case that would be wholly objectionable. That might be the case where it unfairly overrode legitimate interests of creditors pursuant to the contracts governing their relationship with the primary obligor companies or under the system of law, including relevant principles of insolvency law, which applies to the relationship between them." In the case at hand, however, the artificial structure was deemed to be the only viable solution to complete the restructuring of Gategroup, as other alternatives were not practicable and would have impaired creditor recovery. *In the matter of Gategroup Guarantee Limited* [2021] EWHC 304 (Ch); *In the matter of Gategroup Guarantee Limited* [2021] EWHC 775 (Ch).

change if the debtor happens to be a bank with a high degree of market interconnectedness and a global scope of activities? The complexity of the weighting exercise rises with each question posed.

Kelsen points out that the "weighting of interests (*Interessenabwägung*) is merely a formulation of the problem, not a solution."[33] How should one decide what principle prevails in a situation of conflict between legal principles?

5.4 Meta-Principles

5.4.1 Optimisation: Pareto and Kaldor-Hicks efficiency

Legal principles often conflict with each other, necessitating trade-offs, balancing and the need to choose which principle should be prioritised in a given situation. In the context of "hard" cases, where legal principles collide, Burg identifies three standards to guide the resolution of competing principles: (i) requirement of optimisation, (ii) requirement of consistency, and (iii) prohibition of disproportionality. On the basis of these standards, legal principles are viewed as reasons that should be applied optimally, consistently and not in a disproportionate way.[34]

The requirement of optimisation relies on the idea of Pareto optimality, according to which a solution is Pareto-optimal or Pareto-efficient if at least one party benefits from it and no other party is made worse off.[35] If legal principles are viewed as configurations of the economic system, akin to goods, their realisation may be subject to the same considerations. A solution is Pareto-efficient if it promotes one principle and does not diminish the realisation of another principle. It is argued that in insolvency the concept of Pareto efficiency is immanent "where an insolvency decision or choice produces a greater return to some creditors without reducing the return to any other creditor."[36] In group insolvencies, Pareto efficiency might be achieved if, for example, a solution generates returns for some creditors, ensures the survival of viable group members, and safeguards critical functions

33 H. Kelsen, Pure Theory of Law, The Lawbook Exchange Ltd., 2005, p. 352.

34 E. Burg, The Model of Principles. The quest for rationality in the implementation of conflicting principles, Universiteit van Amsterdam, Faculteit der Rechtsgeleerdheid, 2000, p. 175.

35 The principle of efficiency was explained by Vilfredo Pareto in his *Manuel d'économie politique*, Paris, 1909. For discussion, see J. Rawls, A Theory of Justice, Harvard University Press, 1999, p. 58.

36 D. Morrison and C. Anderson, The Australian Corporate Rescue Provisions: How do they Compare? In P. Omar (ed), International Insolvency Law: Reforms and Challenges. Ashgate, Farnham, 2013, p. 196.

and financial stability (e.g. in the case of a financial institution), without damaging the interests of other creditors, whose position is compared to some baseline scenario. However, the following chapters of this book will demonstrate that in insolvency some interests and principles often must give way to other interest and principles. As a result, Pareto efficiency is theoretically possible, but practically unlikely.

An alternative to Pareto efficiency is Kaldor-Hicks efficiency. Kaldor-Hicks efficiency is named after economists Nicholas Kaldor and John Hicks, who formulated it. This type of efficiency approves an outcome that maximises a net gain (total wealth maximisation), even if such an outcome leaves some parties worse off. For example, Kaldor-Hicks efficiency is reached if the aggregate returns to creditors increase, while some creditors of certain group members have to suffer, as long as the benefits to those creditors who are better off exceed the losses of creditors who are worse off, counted in absolute terms. The Kaldor-Hicks efficient outcome is more likely in practice. Yet it could be normatively unattractive because it may encroach on creditors' property rights, pre-insolvency entitlements and legitimate expectations. In theory, creditors who "win" can compensate creditors who "lose", but strictly speaking, this is not required for Kaldor-Hicks efficiency.[37] Besides, it is not clear who should choose the winners and losers and how.

5.4.2 Consistency: alike and unalike cases

Another meta-principle is consistency, which entails the consistent application of legal rules, ensuring that similar cases are resolved in a similar way. Consistency is indispensable for achieving deal certainty and predictability. The similarity aspect relates to both the application of the same principles and the extent of their involvement.[38]

An important side of this meta-principle implies that un-alike cases should be treated in a way that accords to their un-alikeness. While the idea of "treating like cases alike" and accord for differences is appealing, its practical application could face difficulties. For example, consider the provision of intra-group financial support (e.g. an intra-group loan) for restructuring purposes versus financing offered by an external financier to rescue a distressed business. On the one hand, they share similarities as

37 R.A. Posner, Economic Analysis of Law, 8th edn, Aspen Publishers, 2011, p. 17. If such compensation is granted, the outcome is similar to a Pareto-optimal one, since the detriment caused by a group solution to some creditors is remedied. This is why Kaldor-Hicks efficiency is sometimes termed the "potential" Pareto efficiency.

38 E. Burg, The Model of Principles. The quest for rationality in the implementation of conflicting principles, Universiteit van Amsterdam, Faculteit der Rechtsgeleerdheid, 2000, p. 154.

both transactions aim to acquire financing for distressed entities and may be backed by the same principle of value preservation and maximisation. If this holds true, the same rules and priority should apply. On the other hand, the situations are not exactly the same, as one of them involves a related party, which can be treated differently for a valid reason and in a consistent manner. Does this justify denying a related party the protections and privileges available to a non-related party, such as priority or safe harbour? The meta-principle of consistency does not give a definitive answer. So far as a related party is *consistently* treated differently, the requirement of consistency appears to be satisfied.

The main problem of the consistency argument therefore lies in determining "like" and "un-alike" cases. In our view, this initial determination cannot be solely based on the requirement of consistency.

5.4.3 Proportionality: key tool in a balancing exercise

The third meta-principle is proportionality. Proportionality is omnipresent.[39] It regulates the exercise of powers by the European Union,[40] is mandated by the EU Charter on Fundamental Rights,[41] underpins interpretation and application of the European Convention on Human Rights (ECHR) and transpires in many national legal systems.

According to Burg, when applied to a conflict between legal principles, proportionality is achieved if the price (non-realisation of one principle) to be paid for a gain (realisation of a competing principle) is not "out of any reasonable proportion".[42] This may point to a variety of reasonable options or a single answer, assessed from the perspective of a reasonable person.

---

39 For discussion of the principle of proportionality, its origins and areas of application, see B. Pirker, Proportionality Analysis and Models of Judicial Review: A Theoretical and Comparative Study, Europa Law Publishing, 2013. See also Y. Arai-Takahashi, Proportionality, in D. Shelton (ed), The Oxford Handbook of International Human Rights Law, OUP, 2013, p. 446, observing that the principle has its origin in Prussian police law of the 18th century, and that it flourished in Germany after the World War II, turning into a shared analytical tool.

40 Treaty on European Union, Article 5: "The use of Union competences is governed by the principles of subsidiarity and proportionality." R. Schütze and T. Tridimas (eds), Oxford Principles of European Union Law. Volume I: The European Union Legal Order, OUP, 2018.

41 Charter of Fundamental Rights of the EU, Article 52: "Subject to the principle of proportionality, limitations may be made only if they are necessary and genuinely meet objectives of general interest recognised by the Union or the need to protect the rights and freedoms of others."

42 E. Burg, The Model of Principles. The quest for rationality in the implementation of conflicting principles, Universiteit van Amsterdam, Faculteit der Rechtsgeleerdheid, 2000, p. 165.

Alexy further breaks down proportionality into three sub-principles: suitability (whether by taking a measure at least one value or a legitimate aim is furthered), necessity (use of the least intrusive means) and proportionality in the narrow sense (balancing requirement).[43] The latter sub-principle states that "[t]he greater the degree of non-satisfaction of, or detriment to, one right or principle, the greater must be the importance of satisfying the other."[44] Its application could be divided into three stages:

(i) determining the degree of non-satisfaction or detriment to one of the principles;
(ii) assessing the importance of satisfying the competing principle; and
(iii) establishing whether the importance of the latter outweighs the detriment or non-satisfaction of the former.

In a similar vein, but in a different (human rights) context, Barak argues that the proportionality test "examines the proper ratio between the benefit stemming from attainment of the object and the deleterious effect upon the human right."[45]

The approach of the ECtHR to proportionality deserves closer examination since it is used to resolve complex situations of conflicting rights and interests. Proportionality analysis plays a key role in the interpretation of the ECHR. As a general rule, an interference with a protected right should have a legal basis – it must be "in accordance with law" or be "prescribed by law",[46] pursue a legitimate aim (e.g. public safety, protection of health and morals), and strike a fair balance between the competing interests. This fair balance entails an application of the prongs of suitability (relationship between the ends and the means) and necessity (the measure should fall within reasonable options available). The court refuses any rigid understanding of suitability and necessity, recognising a certain leeway or "margin of appreciation", enjoyed by the states.

The fair balance test places most of its weight on the stage of the proportionality *stricto sensu*. It represents an open-ended case-by-case weighting exercise, in which it takes into account facts, the degree of interference and

43 R. Alexy, On Balancing and Subsumption. A Structural Comparison, Ratio Juris, Vol. 16, 2003, p. 436. Some authors distinguish four proportionality rules, singling out legitimate ends (whether the act pursues a legitimate end) and suitability (whether the act is capable of achieving this aim). See M. Klatt and M. Meister, The Constitutional Structure of Proportionality, OUP, 2012, p. 8.

44 R. Alexy, A Theory of Constitutional Rights, OUP, 2010, p. 102.

45 A. Barak, Proportional Effect: The Israeli Experience, University of Toronto Law Journal, Vol. 57, 2007, p. 374.

46 *Sunday Times v. United Kingdom*, Appl. no. 6538/74, Judgment, 26 April 1979, para. 45.

whether such interference impairs the essence of the right,[47] as well as conflicting interests and rights. For example, in *Cipolletta v. Italy*, the court ruled that the excessive duration of the Italian "administrative liquidation" procedure (more than 25 years) amounted to a violation of the right to a fair hearing within a reasonable time.[48] In arriving at this decision, the court acknowledged the complexity of insolvency proceedings, especially concerning the identification and collection of the debtor's assets and their sale. And yet it concluded that the excessive length was not justified. Interestingly, in the concurring opinion, Judge Koskelo argued that more emphasis and attention should have been paid to the special nature of insolvency proceedings, which entail a somewhat limited role of courts and involvement of an IP, collective resolution of complex issues arising from financial distress, and the long-term character of measures necessary to achieve the optimal economic results for creditors.[49]

Because of the transpiring nature of proportionality analysis, it can be used to determine a balance in a particular case involving intra-group financing and insolvency. It will be relied upon in our analysis of various legal tools and solutions that are available or can be proposed *de lege ferenda*. Think of the extension of an enforcement stay to non-debtor group companies, acting as guarantors, co-debtors and collateral providers (Chapter 11). First, it should be acknowledged that this extension has a legitimate goal; it promotes the principle of estate value preservation and maximisation (suitability). Second, the extension of a stay should not be automatic and is more justified in integrated groups (necessity). Third, a restraint of enforcement against a non-debtor shall not unfairly prejudice the rights of affected creditors (e.g. guaranteed creditor, creditor benefitting from collateral) or cause any substantial detriment to them (proportionality in the narrow sense). Such detriment may occur when collateral, held by a debtor's group affiliate, significantly depreciates in value during the extended stay.

5.5 Conclusion

This chapter discusses different strategies for resolving conflicts or collisions between legal principles. These conflicts are ineradicable. In fact, it is fair to say that the entire field of insolvency law is about the resolution of conflicting interests created by the financial distress of a debtor or a group of debtors. How should law deal with such conflicts?

47 S. Van Drooghenbroeck, C. Rizcallah, The ECHR and the Essence of Fundamental Rights: Searching for Sugar in Hot Milk? German Law Journal, Vol. 20, 2019, p. 904-923, questioning usefulness of the concepts of the essence, substance, and core of fundamental rights.

48 *Cipolletta v. Italy*, Appl. no. 38259/09, Judgment, 11 January 2019.

49 Ibid., Concurring Opinion of Judge Koskelo, para. 6.

One way is to embrace the notion of fairness and use it to propose outcomes that satisfy this notion to the greatest extent. While any reference to fairness may be appealing, and we generally tend to agree that fair results are desirable, what is fair and what is unfair is hard to determine in the abstract. The answer will depend on the position taken, the issue at stake, parties involved in a dispute and the quality of legal rules. Another way is to accept that legal principles have the dimension of weight or importance, and therefore, a legal principle with greater weight should determine the outcome of a balancing exercise. Again, as with fairness, the weight cannot be assigned to a legal principle in the abstract. It depends on the totality of facts, interests and values. Finally, one can appeal to meta-principles, such as optimisation, consistency and proportionality. Accordingly, rules must be designed and applied optimally, consistently and proportionately. Among the meta-principles, proportionality plays a key role in determining a balanced solution. It occupies a central place in law and "makes it possible to compare and evaluate interests and ideas, values and facts, that are radically different in a way that is both rational and fair."[50]

The proportionality analysis is necessarily case-specific. However, this does not mean that any attempt to dissect some general factors and fact patters which impact the balancing exercise would be futile. But what are these factors and fact patterns? This question points to the anticipated journey that this book invites the reader to take. It goes to the core of what we are seeking to understand, namely when and in which circumstances special group-mindful tools or solutions are balanced and proportionate.

50 D.M. Beatty, The Ultimate Rule of Law, OUP, 2004, p. 169.

Part IV

Intra-Group Financing and Insolvency: Transactions and Problems

6 Cross-guarantees, Recourse Claims and "Orphan Restructurings"▪

6.1 Introduction

This chapter discusses cross-guarantees, also known as intercompany guarantees or intra-group guarantees. These transactions are common in commercial practice as they seek to improve borrowing terms by providing additional security to a guaranteed creditor, who gains access to the enlarged pool(s) of assets and in this way acquires extra protection against counterparty risk.

The purpose of this chapter is to discuss the operation and functions of guarantees in a group context and to explain the problems they cause in situations of financial distress. In many cases, cross-guarantees facilitate interdependence of group companies and weaken the protections of corporate shields, which in theory should ensure the separateness of legal entities comprising an enterprise group. Instead, cross-guarantees allow for simultaneous filing of claims against both the principal debtor and the guarantor, resulting in group-wide enforcement. While this chapter emphasises the problems, it does not offer solutions, leaving that for other chapters in this book (i.e. Chapters 10-12).

The structure of the current chapter is as follows. First, we clarify the scope of inquiry, i.e. types of transactions at issue (section 6.2.). Second, we describe the operation of a cross-guarantee relationship (section 6.3.). Third, we explain how cross-guarantees might reduce the agency cost of debt (section 6.4.1.) and how they could dilute recoveries of non-guaranteed creditors (section 6.4.2.). Fourth, we note how cross-guarantees may affect the dynamics of insolvency and restructuring. This dynamics is explored by analysing the rights and obligations of relevant parties: principal debtor, group guarantor and creditor – the "triangle of rights and liabilities" (section 6.5.). Here, two questions are examined with reference to national law.

▪ This chapter builds upon the following previously published work by the author:
- I. Kokorin, Promotion of group restructuring and cross-entity liability arrangements, Journal of Corporate Law Studies, Vol. 21, 2021, pp. 557-593.
- I. Kokorin, Third-Party Releases in Insolvency of Multinational Enterprise Groups, European Company and Financial Law Review, Vol. 18, 2021, pp. 107-140.

The first question concerns the effects of insolvency and restructuring of the principal debtor on the rights of the guaranteed creditor against the guarantor (section 6.5.2.). It is shown that while the insolvency of the principal debtor per se does not affect joint and several liability of a third party liable under a guarantee, a voluntary release granted by the creditor to the principal debtor may lead to a discharge of the guarantor. In some instances, where there are several jointly and severally liable parties (e.g. co-sureties), the release of one of them may lead to a discharge of obligations of such other parties.

The second question relates to the consequences of performance by the guarantor, specifically the rights that a paying guarantor may acquire against the principal debtor and how such rights may be exercised during or after insolvency or restructuring (section 6.5.3.). The existence and enforceability of these rights can have direct consequences for the efficiency of the insolvency and restructuring proceedings. In addition to the problems caused by the enforcement of "ricochet" claims against the principal debtor, the very fact that the creditor is entitled to proceed with a claim against other group members (i.e. guarantors or co-debtors) might lead to their financial distress or even insolvency. This can have an impact on the efficiency of the principal debtor's restructuring. These and other ex-post effects of cross-guarantees are summarised in section 6.6. Section 6.7. concludes.

6.2 Cross-guarantees and Co-debtorship Arrangements

The main focus of this chapter is on cross-guarantees – transactions creating secondary liability. It does not deal separately with cases where several group members act as co-borrowers or co-issuers (joint obligors or co-obligors). The latter are examples of primary liability. We note the differences between the cases of primary and secondary liability, for instance, with respect to the scope of potential recourse rights that may belong to a guarantor and co-debtor.[1] Yet our decision not to separately write about co-debtorship is based on the similarities between the economic and legal effects of cross-guarantee and co-debtorship arrangements, the commonality of challenges they pose in restructuring and insolvency of enterprise groups, and the uniformity of legal responses required to respond to these challenges.

1 For example, Under Dutch law, a surety has full recourse against jointly and severally liable debtors (Article 7:866 of the Dutch Civil Code (DCC), while a co-debtor may only be entitled to compensation of an amount exceeding the proportionate share of debt (Article 6:10 DCC).

First, cross-guarantees and co-debtorship arrangements perform a similar "security-granting" function, providing a creditor with access to asset pools of separate entities and purporting to satisfy his interest in receiving full performance. Insolvency of the principal debtor or co-debtor does not release the guarantor and other co-debtors, respectively, from their obligations. Thus, in both situations, the risk of default (and the incentive to control it) rests with an entity whose assets may become available to the creditor. Unless otherwise agreed, such a creditor can typically choose to enforce his claim against a single company or initiate a group-wide enforcement by filing claims against several group entities, acting as co-debtors or guarantors, at once.[2] When the creditor's interest is satisfied by one of the co-debtors or by the guarantor, other co-debtors, guarantors, or the principal debtor are discharged from their obligations to the creditor.

Second, upon satisfaction of the creditor's claim, a joint debtor and a guarantor may be entitled to request compensation from co-debtors or from the principal debtor and other guarantors, respectively. The existence and extent of this compensation in a situation where the underlying debt is restructured (e.g. decreased, postponed) or completely written down might differ and depend on applicable law, the character of discharge (voluntary vs. involuntary), as well as the nature of debt restructuring (pre-insolvency contractual vs. insolvency court-led restructuring). The complexities created by co-debtorship and guarantee relationships are similar.

Third, as will be examined in more detail in the following chapters, insolvency law often treats co-debtorship and cross-guarantee arrangements in the same way, e.g. by sanctioning third-party releases (Chapter 10) or extending an enforcement stay to group guarantors and co-debtors (Chapter 11).[3] These insolvency law tools could also be available to protect a group company acting as a provider of collateral securing performance by the principal debtor.

6.3 How Do Cross-guarantees Work?

Groups of companies are special in many respects, including in the ways group entities attract financing from within and outside the group. The cases of Lehman Brothers, Nortel Networks and Oi Brazil serve as excellent examples of how a corporate group can function as a single economic enterprise, tapping into foreign capital markets, efficiently allocating resources

2 *In re Gessin*, 668 F.2d 1105, 1107 (9th Cir. 1982), confirming that "[i]t has long been established that a creditor is entitled to pursue his claims against others liable on the same debt to the full extent of the amount owed on that debt".

3 See e.g. Dutch Bankruptcy Act, Article 372; Singapore's Insolvency, Restructuring and Dissolution Act (IRDA), Section 65; StaRUG, Section 49(3).

within the group, and seeking the most favourable terms for debt financing. One typical financial arrangement used in all three cases is corporate guarantees. These guarantees represent a risk-reduction tool and involve three parties: (i) main or principal debtor, (ii) guaranteed creditor, and (iii) guarantor.

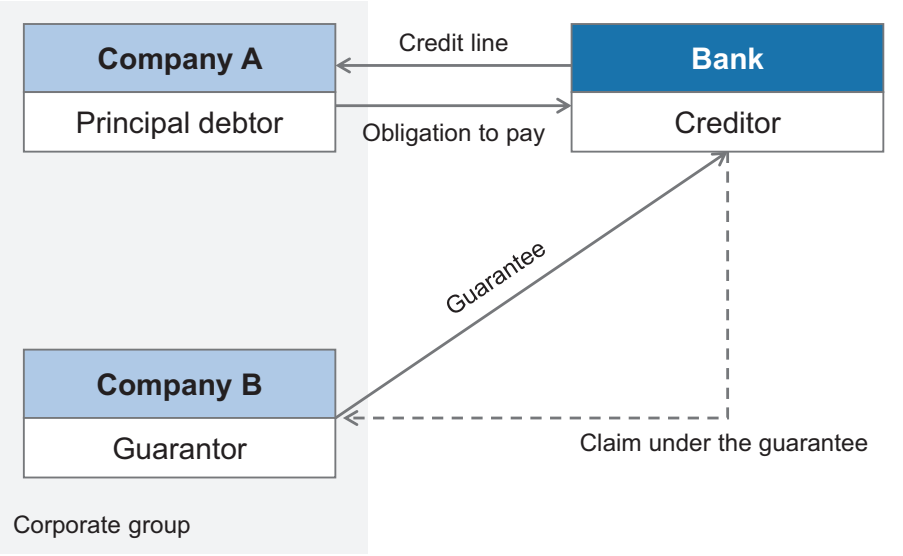

Figure 3. Schematic guarantee relationship

Reading the figure above, a creditor (Bank) has a claim against the principal debtor (Company A), while the latter's performance is guaranteed by another company, the guarantor (Company B). Thus, if the main debtor defaults (i.e. fails to perform his obligation), the creditor is entitled to request performance – usually, payment of a certain amount of money – from the guarantor. As a result, the Bank gains recourse of essentially the same debt from the estates of at least two parties (Companies A and B), depending on the number of co-guarantors involved.

Guarantees may be personal when granted by the debtor's directors or shareholders-natural persons.[4] Personal guarantees often raise specific consumer protection questions and as such fall outside the scope of this book. Corporate guarantees discussed in this book are accessory or co-extensive. They should be distinguished from an independent guarantee (in Dutch "*onafhankelijke garantie*"). Different terms may be used to refer to a type of arrangement whereby the guarantee is independent from an underlying

4 Personal guarantees are particularly common for MSME debtors. See the World Bank Report on the Treatment of MSME Insolvency, 2017 <https://openknowledge.worldbank.org/handle/10986/26709> (accessed 15 July 2023).

obligation (e.g. demand guarantee, demand bond, letter of credit).[5] In contrast, an intercompany guarantee is usually dependent on the underlying obligation and has an accessory nature.[6] This means that the guarantor's liability is contingent upon the principal obligor's continuing liability and default. The term "suretyship" also refers to this accessory agreement. It is sometimes contrasted with a "guarantee", where the latter is used to refer to an independent guarantee.[7]

In order to avoid confusion that may otherwise arise from the use of different terms in different legal systems, this book will use the terms "guarantee" and "suretyship" interchangeably, as an undertaking by the surety or guarantor to be answerable for the debt or obligation of another when that other defaults, and where liability of the surety or guarantor depends upon there being the liability of the principal or main obligor. This simplification, however, is not meant to downplay important nuances in law at the national level. Certain aspects and specifics of national laws will be discussed below.

Guarantees are common in groups, where the parent company guarantees the performance of its subsidiaries (downstream guarantee), where a subsidiary acts as a guarantor for its parent (upstream guarantee), and where one subsidiary guarantees the debt of another subsidiary (cross-stream guarantee).[8] These group guarantees, along with co-debtorship and third-party (group) collateral, are examples of intra-group support transactions.

---

5 See P. Wood, International Loans, Bonds, Guarantees, Legal Opinions, Sweet & Maxwell, 2007, para. 19-016. In this case, the third party's obligation is primary and independent of that of the principal debtor. It arises whether or not a default has occurred and is usually not influenced by matters affecting the contract between the creditor and the main debtor.

6 S. Whittaker, Suretyship, in Chitty on Contracts, 33d edn, Sweet & Maxwell, 2018, para. 45-009, noting that under English law "there is a "strong presumption" that a "guarantee" concluded other than by a bank is not a demand or independent performance bond, although this presumption may be rebutted." However, see P. Ostendorf, Demand Guarantee or Suretyship Guarantee – Have corporate guarantors lost the benefit of the doubt? OBLB, 14 September 2021, discussing recent precedents that may weaken the presumption based on the guarantor's identity.

7 For a historical overview of the appearance and usages of the terms "guarantee" and "suretyship", see M. Radin, Guarantee and Suretyship, California Law Review, Vol. 17, 1929, pp. 605-622. For discussion of US law, see C. Henkel, Personal Guarantees and Sureties between Commercial Law and Consumers in the United States, The American Journal of Comparative Law, Vol. 62, 2014, pp. 333-359.

8 R. Squire, Shareholder Opportunism in a World of Risky Debt, Harvard Law Review, Vol. 123, 2010, p. 1213, noting that intragroup guarantee arrangements are extremely prevalent. See also J.F. Williams, The Fallacies of Contemporary Fraudulent Transfer Models as Applied to Intercorporate Guaranties: Fraudulent Transfer Law as a Fuzzy System, Cardozo Law Review, Vol. 15, 1994, p. 1404, observing that guarantees by companies related to a corporate borrower constitute "a common element of many financial transactions".

They enable a group of companies to be financed as one economic unit, securing beneficial conditions (e.g. lower interest rates and costs, and larger amounts) from outside lenders, like credit institutions and bondholders. Yet they promote group interdependence, as the enforcement of a guarantee or simultaneous filing of claims against multiple co-debtors may create contagion and lead to the spread of distress across corporate boundaries of enterprise group members. These and other features and functions of cross-guarantees are discussed in the following paragraphs.

6.4 Functions of Cross-guarantees

6.4.1 "Protective" function of cross-guarantees

Cross-liability arrangements, such as intercompany guarantees, serve an important "protective function".[9] They provide additional security to a guaranteed creditor by granting him access to and recourse against asset pools of two or more companies ("double dip"). Laws of many jurisdictions, including the UK, the US and the Netherlands, allow a guaranteed creditor to claim full performance from both the principal debtor and the guarantor upon default of the former.[10] This way, the guaranteed creditor acquires protection against idiosyncratic shocks affecting the borrower.

Furthermore, a guaranteed creditor can also benefit when the main debtor (e.g. the issuer of bonds) lends money (e.g. proceeds of bond issuance) to another group entity acting as a guarantor. Both the main debtor and the

9 R. Squire, Limits to Group Structures and Asset Partitioning in Insolvency: Suppressing Value and Selective Perforation by Means of Guarantees, in The 800-Pound Gorilla. Limits to Group Structures and Asset Partitioning in Insolvency, NACIIL 2018 report, Eleven International Publishing, 2019, p. 13.

10 Dutch Bankruptcy Act, Article 136; InsO §43; Italian Bankruptcy Act, Article 61. The same holds true for US and English law. See R. Squire, Limits to Group Structures and Asset Partitioning in Insolvency: Suppressing Value and Selective Perforation by Means of Guarantees, in The 800-Pound Gorilla. Limits to Group Structures and Asset Partitioning in Insolvency, NACIIL 2018 report, Eleven International Publishing, 2019, p. 12, explaining that the "standard American rule is that a lender holding a guarantee can "prove" the full amount of his claim against both the borrower and the guarantor." *Ivanhoe Building & Loan Association v. Orr*, 295 US 243, 245 (1935), where the US Supreme Court held that a creditor did not need to deduct from his claim in bankruptcy an amount received from a non-debtor third party in partial satisfaction of an obligation. Also, *In re National Energy & Gas Transmission, Inc*, 492 F3d 297, 301 (4th Cir 2007); *In re F.W.D.C., Inc.*, 158 B.R. 523 (Bankr. S.D. Fla. 1993); *In re Johnson*, 477 B.R. 879 (M.D. Fla. 2012), confirming this approach. In English law, a guaranteed creditor is entitled to claim the full amount of outstanding debt from both the primary debtor and the guarantor. G. Andrews and R. Millett, Law of Guarantees, 4th edn, Sweet & Maxwell, 2005, p. 473, noting that the "creditor can maintain [proof in the insolvency of the surety] at the same time as a proof for the full amount from the principal and any co-sureties, provided that they are each liable for the whole debt and the creditor does not receive more than 100 pence in the pound."

guaranteed creditor have separate claims against the guarantor – one pursuant to the intra-group loan and the other under the guarantee. As a result, the guaranteed creditor benefits from the direct claim against the guarantor, as well as from the payments that the guarantor makes to the main debtor on the intercompany claim. This structure was established in the Oi Brazil case (and in the Lehman Brothers case), where the bondholders had claims against the Dutch SPVs, which acted as the issuers of bonds. They could also exercise their claims directly against the Brazilian parent company, acting as a guarantor, and indirectly via the claim on intra-group loans (see Figure 4 below).

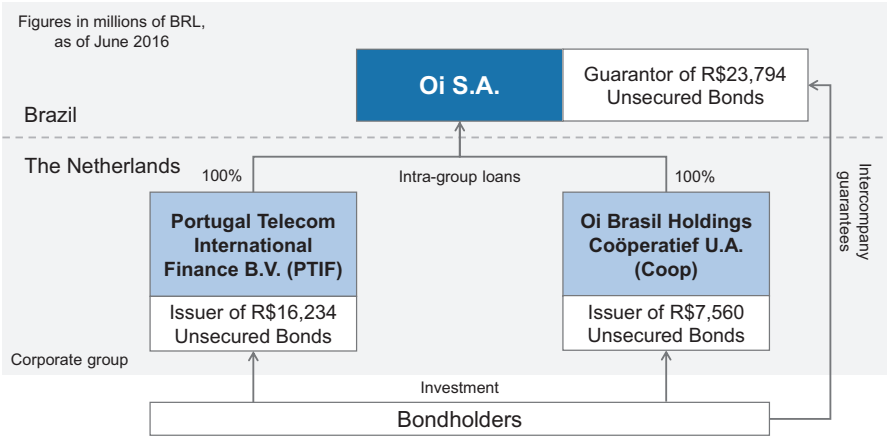

Figure 4. Oi Brazil's intra-group financing[11]

In addition to the described "double dip", a guaranteed creditor receives some protection from intra-group asset shifting or asset stripping – the transfer or taking-out of key assets from one group entity to another, which can enrich the shareholders but could be detrimental to the general body of creditors.[12] Asset stripping is a type of activity that creates what Jensen and Meckling refer to as the "agency cost of debt".[13] The agency cost of debt comprises: (i) monitoring costs, incurred by creditors to limit managerial misbehaviour (e.g. through covenants, their monitoring and enforcement),

11 This figure is based on R.J. Cooper, F.L. Cestero, J.W. Mosier, Oi S.A.: The Saga of Latin America's Largest Private Sector In-court Restructuring, Pratt's Journal of Bankruptcy Law, Vol. 14, 2018, p. 210.

12 A.W. Katz, An Economic Analysis of the Guarantee Contract, The University of Chicago Law Review, Vol. 66, 1999, pp. 73-74; H. Hansmann and R. Squire, External and Internal Asset Partitioning: Corporations and Their Subsidiaries, in J.N. Gordon and W-G. Ringe (eds), The Oxford Handbook of Corporate Law and Governance, OUP, 2018, p. 264.

13 M.C. Jensen, W.H. Meckling, Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure, Journal of Financial Economics, Vol. 3, 1976, p. 305.

(ii) bonding costs, incurred by the debtor to reassure creditors that he will not engage in value-destroying intra-group transfers, and (iii) costs of undeterred misconduct, arising in situation where the expected losses are borne by third parties, which may induce the debtor to overinvest.

Cross-guarantees reduce uncertainty for debtholders and therefore decrease the agency cost of debt. This reduction is attributed to their ability to curtail the negative effects of intra-group asset shifting, thereby lowering information and monitoring costs. The guaranteed creditor no longer needs to actively monitor the debtor and transactions it enters into with its affiliates-guarantors – related-party transactions, which are often particularly difficult to monitor.[14] After all, such a creditor is entitled to file a claim against the debtor and its affiliates, acting as guarantors. This additional security and cost reduction might offset anticipatory losses and lead to reduced costs of debt. A recent study analysed USD commercial and industrial loans with commitments of USD 1 million or more, issued by large bank holding companies in the USA. This study concluded that (i) over 42% of such corporate loans are guaranteed, meaning that there is recourse for full repayment of the credit obligation by a third party, (ii) guaranteed loans have lower bank estimated risk and perform better over time, and (iii) a guarantee provided by the borrower's parent or another group member generates a discount of about 9% of the cost of debt for an average borrowing company.[15]

In sum, intercompany guarantees can facilitate access to finance, improve credit supply, and be ex ante efficient for the debtor,[16] its shareholders and guaranteed creditors – typically banks and other fully or strongly adjusting creditors. However, the overall economic efficiency of intra-group guarantees is not undisputed.[17]

---

14 J. Dammann, Related Party Transactions and Intragroup Transactions, in L. Enriques and T.H. Tröger (eds), The Law and Finance of Related Party Transactions, CUP, 2019, p. 218, noting that "intragroup transactions frequently serve legitimate purposes. On the other hand, the frequency, volume, and depth of such transactions can make them particularly difficult to police."

15 M. Beyhaghi, Third-Party Credit Guarantees and the Cost of Debt: Evidence from Corporate Loans, Review of Finance, Vol. 26, 2022, pp. 287-317.

16 J. Armour et al., How do creditor rights matter for debt finance? A review of empirical evidence, in F. Dahan (ed), Research Handbook on Secured Financing of Commercial Transactions, Edward Elgar Publishing, 2015, pp. 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.

17 R. Squire, Strategic Liability in Corporate Groups, The University of Chicago Law Review, Vol. 78, 2011, p. 618.

6.4.2 "Opportunistic" function of cross-guarantees

While intercompany guarantees protect guaranteed creditors, they dilute the recoveries of non-guaranteed unsecured creditors.[18] This occurs because of the ability of a guaranteed creditor to submit his claim, often in the full amount, against the estates of multiple entities. These claims "compete" with the claims of creditors of those entities. Functionally, the guarantee selectively perforates the entity shields separating legal entities, effectively implementing contractual substantive consolidation for the sole benefit of the guaranteed creditor.[19] The ability of cross-guarantees to transfer value from the guarantor's pre-existing unsecured (non-guaranteed) creditors was termed by Squire as the "opportunistic" function of intragroup guarantees.[20] He argues that the perforation of the enterprise group's internal structure constitutes shareholder opportunism termed "correlation-seeking". In interconnected groups, the insolvency risks of group entities are highly correlated – they tend to thrive and fail together. Thus, in good times, cross-guarantees benefit shareholders by allowing their companies to borrow at lower interest rates, while in insolvency, the triggering of guarantees may have no impact on shareholders because their equity stake in guarantors is wiped out anyway.[21]

A part of the problem is that guarantees are opaque. Unlike some *in rem* security interests, *in personam* security rights are not subject to public registration as a precondition to their validity and effectiveness against third parties. This problem of opaqueness has been noted in academic literature,[22] but there are no generally accepted solutions to it. Usually, a creditor is unaware of the web of contractual arrangements that a debtor is

---

18 Ibid., p. 608.

19 W.H. Widen, Corporate Form and Substantive Consolidation, George Washington Law Review, Vol. 75, 2007, p. 265, noting that "intercompany guarantees create a type of substantive consolidation by contract." Arguably, as "contractual substantive consolidation" benefits only a guaranteed creditor, it is closer to a veil piercing.

20 R. Squire, Limits to Group Structures and Asset Partitioning in Insolvency: Suppressing Value and Selective Perforation by Means of Guarantees, in The 800-Pound Gorilla. Limits to Group Structures and Asset Partitioning in Insolvency, NACIIL 2018 report, Eleven International Publishing, 2019, p. 14.

21 R. Squire, Strategic Liability in the Corporate Group, The University of Chicago Law Review, Vol. 78, 2011, p. 607.

22 Ibid., p. 605, pointing out that the creation of subsidiaries and overuse of guarantees undermines transparency, complicates bankruptcy proceedings and introduces other distortions. See also J.L. Westbrook, Transparency in Corporate Groups, Brooklyn Journal of Corporate, Financial & Commercial Law, Vol. 13, 2018, p. 35, arguing for a regime "in which transparency is required with regard to the structure of a corporate group and the activities of each of its members" and suggesting the disclosure of intercompany guarantees, similar to that applicable to *in rem* security rights under Article 9 of the Uniform Commercial Code (UCC).

involved in. Even if he is, and even if the debtor agrees not to enter into any cross-liability arrangements (thus incurring bonding costs), creditor control over future transactions is problematic, and the monitoring costs might be excessively high, especially for unsophisticated creditors who lack the skills and incentives (e.g. due to the costs being higher than the expected benefits) to engage in it. In the end, these creditors are left in the dark and face the difficult task of calculating the risk of loss from the debtor's insolvency. Given the dilution of potential returns in insolvency, a creditor can either ask for *in rem* security or charge higher interest rates, ultimately increasing the agency cost of debt. However, these adjustments are unavailable if all or most of the debtor's assets are pledged or if the creditor cannot effectively negotiate the terms. This applies first and foremost to involuntary and poorly adjusting creditors.[23]

Another ex-ante effect attributed to cross-guarantees relates to the incentives of creditors to screen and monitor the debtor. Sophisticated lenders, who would otherwise keep track of the debtor's recordkeeping and major transactions, arguably lose impetus to do so because intra-group guarantees make them indifferent or less attentive to the issue of value allocation within the group.[24] Certainly, a guarantee does not make credit risk disappear; it simply shifts risk-monitoring to the guarantor.[25] This risk-shifting is efficient if the guarantor is a better risk bearer. This is likely not the case for group guarantors, as their ability to efficiently monitor the principal debtor is questionable due to the close bonds between such debtor and the guarantor in the group context. This is especially true for upstream guar-

23 Non-adjusting creditors are those creditors which do not adjust the size and terms of their claims to anticipate future developments and security interests encumbering borrower's assets. Among such creditors are tort creditors, tax and regulatory claims. Poorly-adjusting creditors are voluntary creditors with few incentives or possibilities to bargain for security, e.g. due to a small size of a claim or high transaction costs of negotiations. See L.A. Bebchuk and J.M. Fried, The Uneasy Case for the Priority of Secured Claims in Bankruptcy, The Yale Law Journal, Vol. 105, 1996, p. 864; L. Enriques and M. Gelter, How the Old World Encountered the New One: Regulatory Competition and Cooperation in European Corporate and Bankruptcy Law, Tulane Law Review, Vol. 81, 2007, p. 583.

24 H. Hansmann and R. Squire, External and Internal Asset Partitioning: Corporations and Their Subsidiaries, in J.N. Gordon and W-G. Ringe (eds), The Oxford Handbook of Corporate Law and Governance, OUP, 2018, p. 264, noting that intra-group guarantee leaves a guaranteed creditor largely indifferent to the division of assets between group entities. See also R. Squire, Strategic Liability in the Corporate Group, The University of Chicago Law Review, Vol. 78, 2011, p. 617, arguing that without intra-group guarantees "major lenders would pressure group managers to keep better records for each constituent entity, or to pare away extraneous subsidiary boundaries."

25 A.W. Katz, An Economic Analysis of the Guarantee Contract, The University of Chicago Law Review, Vol. 66, 1999, p. 59, observing that guarantees "help protect creditors against some of the risks of debtor misbehavior or insolvency by shifting those risks to guarantors."

antees, provided by subsidiaries with insufficient information on group performance (information asymmetry) or the ability to monitor and influence the parent company.[26] The resulting lack of efficient creditor oversight might contribute to managerial insulation. This is particularly problematic for enterprise groups with concentrated ownership, which might correlate with a higher risk of opportunistic behaviour by shareholders vis-à-vis creditors.[27]

In sum, the economic rationale of intercompany guarantees relates to 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, leading to the reduced agency cost of debt, lower interest rates, and generally advancing the group's ability to raise capital. That being said, the cost reduction is selective and concerns only guaranteed creditors, while the outcome for non-guaranteed unsecured creditors can be the opposite. This is because non-guaranteed creditors may have to incur monitoring costs and sustain potential dilution of recoveries in insolvency. Group guarantees could also influence the degree of creditor oversight, since the guaranteed creditor may be indifferent to intra-group transfers of assets, knowing that he has recourse against several or all group entities. This can worsen the moral hazard problem.

6.5 Insolvency and Triangle of Rights and Liabilities: Principal Debtor, Creditor and Guarantor

6.5.1 Cross-guarantees and insolvency: important questions

Imagine the following scenario. A group of companies consists of Company A (principal debtor and borrower) and Company B (guarantor). The creditor is the Bank that extends a credit line to Company A, with Company B guaranteeing its repayment.

26 A. Jonkers, Insider guarantees in corporate finance: An economic analysis of Dutch, US and German law, PhD thesis, 2020, p. 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 sophisticated lenders has been emphasised with respect to the provision of collateral. See M. Manove, A.J. Padilla and M. Pagano, Collateral versus Project Screening: A Model of Lazy Banks, The RAND Journal of Economics, Vol. 32, 2001, pp. 726-744.

27 A. Gurrea-Martínez, Insolvency Law in Emerging Markets, Ibero-American Institute for Law and Finance, Working Paper 3/2020, 2020 <https://ssrn.com/abstract=3606395> (accessed 15 July 2023).

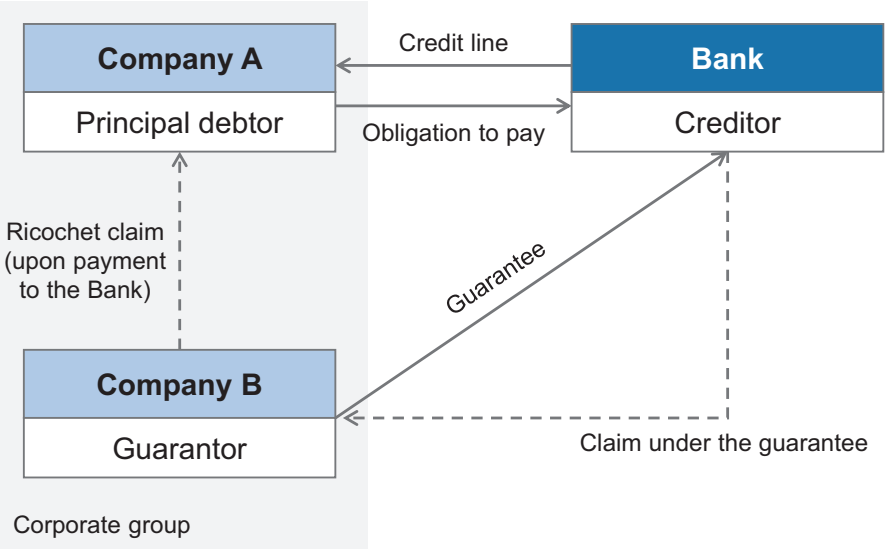

Figure 5. Triangle of rights and liabilities in group financing

Company A experiences financial distress and becomes insolvent or enters a restructuring proceeding, in which the claim of the Bank is significantly curtailed or is fully written down. In the triangle of rights and liabilities between the principal debtor, the guarantor and the creditor, the following questions arise:

(i) Does insolvency of Company A impact the claim of the Bank against Company B? Does the restructuring of the Bank's claim against Company A impact the claim of the Bank against Company B? In other words, can the Bank, despite Company A's insolvency or alteration or discharge of the Bank's claim against Company A in the restructuring proceedings, require performance from the guarantor and in what amount?

(ii) Can Company B, having performed its obligation to the Bank under the guarantee, file a "ricochet" (recourse) claim against Company A and in what amount? Here, the use of the terms "ricochet" and "recourse" is not meant to describe a particular legal qualification or relationship under which the claim arises (e.g. subrogation, indemnity). Instead, it describes a three-party situation in which there is liability for the same debt resting on two parties, and one of them (e.g. surety) has been legally compelled to pay. In these circumstances, upon the payment to the third party, the paying party may become entitled to recover from another party whose debt to the third party is discharged.[28]

28 On this three-party relationship, see C. Mitchell, The Law of Contribution and Reimbursement, OUP, 2013.

The following sections explore these questions with reference to the rules of national law, since the answers may differ depending on the law which governs the relations between the parties. As we dive into the specifics of national law and guarantee relationships, it will become clear that cross-guarantees could complicate group restructuring and impact long-term effectiveness of a restructuring plan.

6.5.2 Insolvency of the principal debtor and claim against a guarantor

6.5.2.1 The UK: co-extensiveness and discharge of guarantor's liability

There is a consensus among all three jurisdictions studied in this book that financial distress or insolvency of the principal debtor per se does not affect the creditor's rights against a guarantor. Thus, a creditor may lodge a proof in the debtor's insolvency proceedings for the full outstanding balance and simultaneously sue the guarantor and enforce his claim against it to the extent to which the creditor has not received payment from the debtor's estate and up to the limit for which the guarantor has engaged itself. This approach is taken in English law.[29] It is premised on the very purpose of a personal security right. It is precisely the insolvency of the principal debtor – a counterparty risk – that the guarantee seeks to provide a safety net against. Any other interpretation would undermine the protective function of the guarantee.

Insolvency of the principal debtor does not affect the liability of a guarantor. The question remains whether the discharge or alteration of debt in the proceedings concerning the principal debtor has any impact on the guarantor's liability. Under English law, generally, a discharge in bankruptcy of a debtor-individual does not affect the guarantor's liability. This expressly follows from the Insolvency Act 1986.[30] The same result is achieved if the principal debtor-entity is liquidated by reason of insolvency.[31] The rationale behind this position is that "the surety cannot complain of what is not the act of the creditor but […] an act arising by operation of law."[32] Insolvency of the principal debtor, therefore, falls within the risk assumed by the guarantor, unless otherwise agreed by the creditor with the guarantor.

---

29 R. Goode and L. Gullifer, Goode and Gullifer on Legal Problems of Credit and Security, 6th edn, Sweet & Maxwell, 2017, para. 8-27. Note that lodging a proof of claim in insolvency proceedings may not always be needed, see e.g. Article 57 Fw.

30 Insolvency Act 1986, s. 281(7).

31 G. Moss, D. Marks, Rowlatt on Principal and Surety, 6th edn, Sweet & Maxwell, 2011, para. 12-05, clarifying that "[a]s in the case of bankruptcy, the liquidation or administration of a company will not release the surety for a company's obligations".

32 Ibid., para. 8-22.

However, what happens if the principal debtor enters into a company voluntary arrangement, a scheme of arrangement under Part 26, or a restructuring plan under Part 26A of the Companies Act? Goode points out that "it is a well-established principle of suretyship law that release of the principal debtor, an agreement not to sue him or a variation of the terms of the principal obligation discharges a surety unless the creditor reserves his rights against the surety either as a term of the guarantee or as a term of the release or other arrangement with the debtor."[33] This follows from the principle of co-extensiveness of the guarantor's liability.[34] The basis for the general rule that the release of the principal debtor, without more, discharges the guarantor is that the release of the principal debtor may interfere with the guarantor's right to sue the principal debtor for compensation.

The creditor and debtor should not be able to put the rights of the surety in danger. This is why it was held that in accepting the release subject to the reservation by the creditor of his rights against the surety, the principal debtor impliedly consents to the preservation of the surety's rights against the debtor, notwithstanding the release, so that the surety is not prejudiced.[35] Other arguments which support the discharge of the guarantor relate to the fact that: (i) the guarantor has agreed to be liable for a specific debt, and if that debt is released without the guarantor's consent, the justification for holding it liable for that same debt no longer holds, (ii) the function of a guarantee is usually to ensure the payment of a sum of money, but if that sum is no longer due, the basis of the surety's liability becomes unclear.

The release by a creditor of a surety who is jointly or jointly and severally liable can also lead to a discharge of co-sureties, unless remedies have been reserved against them.[36] The reason for this is that the release of a surety might prejudice the rights of contribution that co-sureties may be entitled to if the release were effective against co-sureties. In English law, the right of contribution is an independent right of a surety, based on the

33 K. van Zwieten, Goode on Principles of Corporate Insolvency Law, 5th edn, Sweet & Maxwell, 2018, para. 12-26. *Mahant Singh v. U Ba Yi* [1939] AC 601; *Perry v. National Provincial Bank of England* [1910] 1 Ch. 464, observing that "it is perfectly possible for a surety to contract with a creditor in the suretyship instrument that notwithstanding any composition, release, or arrangement the surety shall remain liable although the principal does not."

34 L. Smith, Security, in A. Burrows (ed), Principles of English Commercial Law, OUP, 2015, para. 8.174, noting that "the guarantor cannot be liable except to the extent that the primary debtor is liable." G. Andrews, R. Millett, Law of Guarantees, 6th edn, Sweet & Maxwell, 2011, para. 6-002, explaining that the co-extensiveness principle means that "as a general rule, the surety's liability is no greater and no less than that of the principal, in terms of amount, time for payment and the conditions under which the principal is liable."

35 *Greene King Plc v. Stanley* [2002] B.P.I.R. 491, at 80.

36 S. Whittaker, Suretyship, in Chitty on Contracts, 34th edn, Sweet & Maxwell, 2021, para. 47-122. If co-guarantors are only severally liable, the release of one of them does not discharges others fully, but only to the extent that they are prejudiced by such a release.

understanding that co-sureties have a common interest and a common burden.[37] Therefore, if the surety pays the principal debt, he should be able to claim contribution from co-sureties, because he discharged their obligations (common liability) to the creditor.[38] The idea is that since the suretyship creates a common burden that should be borne equitably by all co-sureties, no surety can be required, as between himself and co-sureties, to pay more than his due share.[39] In this regard, it is pointed out that "it is immaterial that the sureties are jointly, severally or jointly or severally liable, that they are bound by different instruments, or at different times, or that they know nothing of each other's existence as such, or that the first surety agreed to be bound before the co-surety was approached."[40]

Crucially, as the burden of paying a creditor should be ultimately borne by the principal debtor rather than (co-)sureties, "a surety who wishes to recover a contribution from a co-surety must join the principal debtor to his proceedings, or else prove that he is insolvent."[41] The purpose of this rule is to reduce the risk of multiplication of suits filed by co-sureties against the principal debtor – each for an indemnity for their ratable share.

If the creditor agrees to release the principal debtor from any liability by a valid agreement, the guarantor is discharged,[42] unless the guarantor agrees upfront that the primary obligation – or certain aspects of it – may be changed as between the principal debtor and the creditor without affecting the creditor's rights against the guarantor. Since a variation or release under a CVA is treated as consensual, it discharges the guarantor unless the guarantee provides otherwise (i.e. retaining the liability of the guarantor notwithstanding dealings between the creditor and the principal debtor).[43] In other words, a CVA is considered to be equivalent to a consen-

---

37 G. Andrews, R. Millett, Law of Guarantees, 4th edn, Sweet & Maxwell, 2011, para. 12-001; *Dering v. Winchelsea (Earl)* (1787) 1 Cox. Eq. Cas. 318.

38 *Ellesmere Brewery Co v. Cooper* [1896] 1 Q.B. 75. J.D. Heydon, M.J. Leeming and P.G. Turner (eds), Meagher, Gummow and Lehane's Equity Doctrines and Remedies, 5th edn, Chatswood: LexisNexis, 2015, paras. 10-040 to 10-045.

39 *Dering v. Winchelsea (Earl)* (1787) 1 Cox 318; 29 E.R. 1184; *Craythorne v. Swinburne* (1807) 14 Ves. Jun. 160 at 165; *Mahoney v. McManus* (1981) 180 C.L.R. 370 at 376; *Lavin v. Toppi* [2015] HCA 4; (2015) 254 C.L.R. 459 at 32-34.

40 G. Andrews, R. Millett, Law of Guarantees, 4th edn, Sweet & Maxwell, 2011, para. 12-001.

41 C. Mitchell, The Law of Contribution and Reimbursement, OUP, 2013, para. 5.29; *Hay v. Carter* [1935] Ch. 397, CA.

42 G. Andrews, R. Millett, Law of Guarantees, 7th edn, Sweet & Maxwell, 2015, para. 9-010.

43 *Johnson v. Davies* [1999] Ch. 117, considering the effects of an individual voluntary arrangement (IVA), made under Part VIII of the Insolvency Act 1986 and expressing the view that the general law, by which a composition or arrangement between a debtor and his creditors releases sureties, applies to an IVA. *Lombard Natwest Factors Limited v. Koutrouzas* [2002] EWHC 1084 (QB), [2003] BPIR 444 (surety was not released by an IVA of a co-surety when a guarantee expressly provided that it would not be affected by indulgence granted to a co-surety).

sual arrangement outside insolvency proceedings (workout). The case of schemes of arrangement under Part 26 and restructuring plans under Part 26A of the Companies Act 2006 is treated differently. For example, unlike CVAs, schemes of arrangement and Part 26A restructuring plans require the court sanction.[44] English courts confirm that schemes of arrangement operate to produce a discharge or variation of debtor's obligations *by operation of law* and not by virtue of an agreement between the parties, whether actual or deemed.[45] Therefore, a scheme does not discharge a guarantor or joint debtor.[46] The same applies to a Part 26A restructuring plan, as this procedure is intended to draw on practice and principles applied by courts in sanctioning schemes of arrangement.[47]

The fact that schemes of arrangement (and by analogy Part 26A plans) do not discharge the guarantor is also supported by cases in which courts approved schemes of arrangement with a third-party release, noting that in the absence of such a release, the pursuit of the guarantor by a creditor will undermine the compromise between the creditor and the debtor.[48] The same approach was taken where two companies were jointly liable as co-obligors for the same debt. Specifically, it was noted that without the release of co-obligors, they would be liable for the entire debt and may be entitled to claim a contribution from the scheme company, a form of ricochet claim discussed in the following sections of this chapter.[49] If there were a discharge of guarantors or co-debtors by operation of law, inclusion of a third-party release in schemes of arrangement would be superfluous.

---

44 Companies Act 2006, Part 26, s. 899 and Part 26A, s. 901F.

45 *Oceanfill Ltd v. Nuffield Health Wellbeing Ltd & Anor* [2022] EWHC 2178 (Ch), at 25ff.

46 G. Moss, D. Marks, Rowlatt on Principal and Surety, 6th edn, Sweet & Maxwell, 2011, para. 8-22; K. van Zwieten, Goode on Principles of Corporate Insolvency Law, 5th edn, Sweet & Maxwell, 2018, para. 12-26. For authorities on the predecessors of s. 899 of the Companies Act, see *Re London Chartered Bank of Australia* [1893] 3 Ch. 540; *Dane v. Mortgage Insurance Corp Ltd* [1894] 1 Q.B. 54; *Re Garner's Motors Ltd* [1937] Ch. 594, at 599, observing that the "scheme when sanctioned by the court becomes something quite different from a mere agreement signed by the parties. It becomes a statutory scheme."

47 *Re Virgin Atlantic Airways Ltd* [2020] EWHC 2191 (Ch), at 17-18. Restructuring plans have not been widely used. Between 26 June 2020 and 30 June 2023, in England and Wales, 21 companies had a restructuring plan registered at Companies House. See Official Statistics. Monthly Insolvency Statistics, June 2023, released 18 July 2023.

48 *In the Matter of Swissport Fuelling Ltd* [2020] EWHC 1499 (Ch), at 44, pointing out that a "scheme may operate to release or modify the obligations of guarantors, as otherwise the creditors could claim against the guarantors, which would, in turn, be able to make what is called a ricochet claim against the borrower, thereby defeating the purpose of the scheme." That the scheme may be utilised to effect releases of guarantees is shown by cases such as *Re Noble Group Ltd* [2019] BCC 34 and *Re APCOA Parking Holdings GmbH* [2015] Bus LR 374.

49 *Re Lecta Paper UK Ltd* [2020] EWHC 382 (Ch).

6.5.2.2 *The USA: modification or release of primary obligation in and outside bankruptcy*

In the USA, the regulation of guarantees and suretyships has primarily evolved from common law. Additionally, all US states have enacted statutes that regulate this three-way contractual relationship, wherein one party (secondary obligor) agrees to be responsible to the creditor for an underlying obligation of another party (principal obligor).[50] While some of these statutes distinguish between suretyships and guarantees, others do not do so. The Uniform Commercial Code states that "surety" includes "a guarantor or other secondary obligor."[51] The Restatement of the Law (3rd) Suretyship and Guaranty (Restatement), influential authority in this area, observes that "[d]ifferences between these two mechanisms have been the subject of extended debate, not all of which is illuminating. A "surety" is typically jointly and severally liable with the principal obligor on an obligation to which they are both bound, while a "guarantor" typically contracts to fulfill an obligation upon the default of the principal obligor."[52] Given the lack of a uniform body of law on suretyships and guarantees and the fact that the same rules will often apply, whether a transaction is treated as a suretyship or a guarantee, technical differences are left out.[53] Instead, as before, we focus on the interplay between a guarantee and bankruptcy. The latter is regulated at the federal level.

Most US states follow the common law approach, allowing the creditor to choose whether to first sue the principal debtor, the surety, or both of them simultaneously.[54] In other words, upon the default of the principal debtor, the creditor does not have to file a claim against that debtor before turning to the surety. This rule applies to both suretyship and "guarantee of payment". Yet if the guarantee is a "guarantee of collection", the guarantor only incurs liability if the creditor has been unable to collect from the principal debtor using reasonable diligence.[55] In practice, guarantees of collection

---

50 C. Henkel, Personal Guarantees and Sureties between Commercial Law and Consumers in the United States, American Journal of Comparative Law, Vol. 62, 2014, p. 334.

51 UCC, § 1-201(b)(39).

52 Restatement 3d, Suretyship and Guaranty, § 1; F.S.H. Bae and M.E. McGrath, Rights of a Surety (or Secondary Obligor) under the Restatement of the Law, Third, Suretyship and Guaranty, Banking Law Journal, Vol. 122, 2005, p. 786, noting that "there is considerable dispute about the distinction between a surety and a guaranty" and pointing out that "the variations of statutory definitions among the jurisdictions do not generally affect the substantive law or the outcome of cases."

53 For discussion of differences and similarities between a guarantee and suretyship, see T. Eisenberg (ed), Debtor-Creditor Law, Matthew Bender & Company, Inc., 2022, § 44.03.

54 Ibid., § 45.07.

55 See *Chahadeh v. Jacinto Med. Group, P.A.*, 519 S.W.3d 242, 246 (Tex. App. 2017), noting that a "guaranty of collection is an undertaking of the guarantor to pay if the debt cannot be collected from the primary obligor by the use of reasonable diligence, and requires the lender to pursue the principal debtor before collecting."

are rarely used, and group guarantees are almost always unconditional "guarantees of payment".[56] If the performance of an underlying obligation is secured by collateral, the creditor may be required to proceed against the collateral first, provided that doing so does not cause any substantial injury.[57] However, if there are several secondary obligors, such as co-sureties, a creditor may proceed against any of them regardless of their relative rights, as long as the creditor does not receive double recovery.[58]

It is not uncommon for the principal debtor to enter into a settlement with a creditor. Sections 39-41 of the Restatement address the effects of a release, extension, and modification of an underlying obligation.[59] As a general rule, the "release, extension, or modification discharges the secondary obligor from its duties pursuant to the secondary obligation either completely or to the extent that the obligee's [creditor's] act would otherwise cause the secondary obligor a loss."[60] If the *modification* of an underlying obligation is material, affecting the nature, meaning, or legal effect of this obligation, and if it prejudices the surety, such surety is discharged, unless it consents to the material change.[61] The material change should impose risks on the surety fundamentally different from those imposed prior to it. If the change is not material, the surety is not discharged, but its obligation is reduced to the extent of loss due to the modification (*pro tanto*).[62] It is observed that "whether a change has been made that will discharge a surety is a question of fact, and subtle factual distinctions can lead to apparently inconsistent results."[63]

The preceding paragraph tackled the modification of an underlying obligation. Let us now turn to a *voluntary release*. Whenever a creditor releases a principal debtor, a surety is discharged. As in English law, this is based

56 A.J. Casey, The New Corporate Web: Tailored Entity Partitions and Creditors' Selective Enforcement, The Yale Law Journal, Vol. 124, 2015, p. 2680.

57 C. Henkel, Personal Guarantees and Sureties between Commercial Law and Consumers in the United States, American Journal of Comparative Law, Vol. 62, 2014, p. 352.

58 P.A. Alces, The Law of Suretyship and Guarantee, Thomson Reuters, 2021, § 5:4; Restatement 3d, Suretyship and Guaranty, § 53, comment a.

59 Restatement 3d, Suretyship and Guaranty, §§ 39-41.

60 Restatement 3d, Suretyship and Guaranty, Introductory Note to §§ 39-41. For a similar rule, see UCC, §3-605(c).

61 *Autumn Manor, Inc. v. Jones*, No. 03-4083-SAC (D. Kan. Aug. 19, 2003); *Frost Nat'l Bank v. Burge*, 29 S.W.3d 580 (Tex. App. 2000). Note that in some US states, absent consent of a surety, any change in the principal's duties that increases such duties will discharge the surety. See e.g. Cal. Civ. Code § 2819; Ga, Code § 10-7-21.

62 *National Sur. Corp. v. United States*, 118 F.3d 1542 (Fed. Cir. 1997). The rule of *pro tanto* discharge is followed in § 3-606 UCC.

63 T. Eisenberg (ed), Debtor-Creditor Law, Matthew Bender & Company, Inc., 2022, § 45.06.

on the co-extensive or accessory nature of the surety's obligation.[64] The discharge occurs unless either of the following conditions is met. First, the terms of the release preserve the surety's right of recourse against the principal debtor. If this is the case, the release does not prejudice the surety, because it maintains the reimbursement right. Second, the language or circumstances of the release confirm the creditor's intent to retain the claim against the surety.[65] "Reservation of rights" clauses are common in practice. However, a surety is nevertheless discharged to the extent it would otherwise suffer a loss due to the release.[66]

A guarantor who performs after the release of an underlying obligation generally has no recourse against the principal debtor. This is because the release of an underlying obligation discharges not only the duty of the principal debtor to the guaranteed creditor but also the duties of performance and reimbursement owed to the guarantor. Notably, the guarantor also does not acquire subrogation rights. As a consequence of this lack of recourse, the guarantor could suffer a loss to the extent that, in the absence of the release, there would have been recovery from the principal debtor. To prevent unfair outcomes, the guarantor is discharged to the extent necessary to avoid such loss.[67]

The same logic applies to the release of a co-surety or co-guarantor. State law typically provides for a right of contribution between co-sureties or co-guarantors based on a theory of implied contract. Hence, when two or more persons guarantee the debt of another, they simultaneously enter into "an implied promise on the part of each to contribute his share if necessary to meet the common obligation."[68] Co-sureties are treated as though they agreed among themselves to share the cost of their performance. Pursuant to the Restatement, a co-surety is entitled to a contribution if he pays more than his contributive share, since as "between cosureties for the same underlying obligation, each cosurety is a principal obligor to the extent of its contributive share […] and a secondary obligor as to the remainder of its

64 On this point, suretyship should be distinguished from a standby letter of credit, which creates an independent, primary obligation. P.A. Alces, The Law of Suretyship and Guarantee, Thomson Reuters, 2021, § 2.8, observing that "assurance of payment on demand, without condition, is the distinguishing feature of the standby credit." J.F. Dolan, Standby Letters of Credit and Fraud (Is the Standby Only Another Invention of the Goldsmiths in Lombard Street?), Cardozo Law Review, Vol. 7, 1985, pp. 1-45.

65 Restatement 3d, Suretyship and Guaranty, § 39(b).

66 Ibid., § 39(c)(ii).

67 Ibid., § 39, comm. f. Arguably, if the principal debtor has no assets and the recovery on the recourse claim would not lead to any payment to the guarantor, there is no loss and no discharge.

68 *Waters v. Waters*, 148 A. 326, 327 (Conn. 1930); *Lestorti v. DeLeo*, 4 A.3d 269, 275, 298 Conn. 466, 473 (Conn., 2010).

duty pursuant to its secondary obligation."[69] A right of contribution therefore arises if a surety pays in excess of the share which, as between itself and co-sureties, it ought to bear.[70] In principle, if a surety is released by an act of a creditor from its obligation, which affects the right of contribution of a co-surety, this co-surety is discharged.[71]

In sum, applying US law may lead to a similar outcome as achieved under English law. Both legal systems aim to protect the surety in the understanding that the creditor and principal debtor should not be able to put the rights of a surety in danger or to place the ultimate burden solely on the surety or one of the co-sureties. It is important to stress that in practice, the effect in the form of a discharge is often prevented or waived in a guarantee agreement.[72]

This brings us to the bankruptcy scenario. As previously noted, US law permits a guaranteed creditor to sue the principal debtor and guarantor(s) simultaneously. If they are insolvent, the creditor can assert the entire claim (as it existed on the petition date) against the estates of each obligor and recover in each proceeding on the basis of the entire amount, provided that this creditor does not collect more, in total, than the amount owed to him. Until the creditor's claim has been fully satisfied, it does not need to be reduced to reflect any partial distributions in the insolvency proceedings.[73]

---

69 Restatement 3d, Suretyship and Guaranty, § 55.

70 Restatement 3d, Suretyship and Guaranty, § 57(1) ("Subject to subsection (2) and to any express or implied agreement between or among the cosureties, a cosurety's contributive share is the aggregate liability of the cosureties to the obligee divided by the number of cosureties").

71 See Restatement 3d, Suretyship and Guaranty, § 54, providing the following illustration: "To induce C to lend D $ 10,000, S[1] and S[2] guarantee D's obligation to repay the loan under circumstances such that S[1] and S[2] are cosureties with equal contributive shares. D defaults on the loan and has no assets. In exchange for $ 500, C releases S[1], who is solvent, from its guaranty and pursues S[2]. Pursuant to § 39, the release of S[1]'s duty to C also releases S[1]'s corresponding duty to S[2] and, accordingly, reduces the amount S[2] could recover from S[1] from $ 4,500 (the remainder of S[1]'s contributive share) to $ 0. Therefore, S[2] is discharged to the extent of $ 4,500 from the remaining $ 9,500 owed to C."

72 B.D. Hulse, After the Guarantor Pays: The Uncertain Equitable Doctrines of Reimbursement, Contribution, and Subrogation, Real Property, Trust and Estate Law Journal, Vol. 51, 2016, p. 51; F.S.H. Bae, M.E. McGrath, Rights of a Surety (or Secondary Obligor) under the Restatement of the Law, Third, Suretyship and Guaranty, Banking Law Journal, Vol. 122, 2005, p. 807, observing that it is common practice for a contract between a surety and a creditor "to be chock full of waivers inserted by the obligee's [creditor's] attorney."

73 B.E. Greer, J.S. Moss and N.B. Herther-Spiro, Guarantees in Bankruptcy: A Primer II, Norton Annual Survey of Bankruptcy Law, 2014 edn, p. 180. *Bd. of Comm'rs v. Hurley,* 169 F. 92, 97 (8th Cir.1909); *Reconstruction Fin. Corp. v. Denver & Rio Grande W. R.R. Co.*, 328 U.S. 495, 529 (1946); *In re Nat'l Energy & Gas Transmission, Inc.*, 492 F.3d 297, 301 (4th Cir.2007).

The question remains whether the bankruptcy discharge of the principal debtor also discharges the surety. When answering this question, we should keep in mind that one of the primary reasons for a creditor to seek a personal security right, such as a guarantee, is to protect itself in case the principal debtor becomes bankrupt and receives a discharge in a bankruptcy proceeding.[74] The US Bankruptcy Code stipulates that the discharge of the debtor's debt does not affect the liability of any other entity on, or the property of any other entity for, such debt.[75] This is logical since the bankruptcy discharge does not extinguish or cancel the debt but merely releases the debtor from personal liability.[76] Therefore, a bankruptcy discharge, including Chapter 11 discharge, does not affect the liability of a co-debtor or surety for the discharged debt unless the plan provides for a release of third parties. Consequently, a surety remains liable for the original debt and not for the partly discharged debt; and Chapter 11 confirmation does not bar litigation against third parties for the remaining amount. One court has explicitly stated that extending "the rule of equivalent liability [liability of a surety equals liability of the bankrupt principal debtor] into the bankruptcy context would destroy the value of a guarantee."[77]

To conclude, the discharge of debt through a bankruptcy route, as opposed to a settlement outside bankruptcy (i.e. workout), does not impact the obligations of persons secondarily liable inasmuch as such a discharge is effected by operation of law.[78] This argument should be familiar to the reader, as it was previously mentioned in relation to English schemes of arrangement and restructuring plans.

---

74 Restatement 3d, Suretyship and Guaranty, § 34, comm. b. The term "personal security right" is not common in the USA. The terms "guarantee" and "suretyship" are used instead. In the USA, "security interest" usually refers to a form of collateral (i.e. *in rem* security right). In the UK, the term "security" has traditionally been used to describe rights over assets. Yet these days it can refer to both "proprietary" or "real" security and "personal" security. See R. Goode, L. Gullifer, Goode and Gullifer on Legal Problems of Credit and Security, 6th edn, Sweet & Maxwell, 2017, para. 1-06, noting that real security means "security in an assets, whether of the debtor or of a third party" and that real security "is to be contrasted with personal security, that is, security in the form of a personal undertaking which reinforces the debtor's primary undertaking to give payment or other performance."

75 11 US Code § 524(e).

76 *In re Hepburn*, 27 B.R. 135 (Bankr. E.D.N.Y. 1983); *In re Lembke*, 93 B.R. 701, 702 (Bankr. D.N.D.1988).

77 *In re Gentry*, 807 F.3d 1222, 1227 (10th Cir. 2015).

78 *NCNB Texas Nat. Bank v. Johnson*, 11 F.3d 1260, 1266 (5th Cir. 1994), noting that "[r]eorganization proceedings are judicial, not contractual, even where a secured creditor voluntarily participates." *Citizens Bank of Pennsylvania v. Fine Cap. Assocs*., 2014 WL 10558250 (Pa. Super. Ct. 2014); *In re Arrowmill Dev. Corp*., 211 B.R. 497, 506 (Bankr. D.N.J. 1997).

6.5.2.3 The Netherlands: suretyship, draagplicht and 403-statements

6.5.2.3.1 Insolvency and rights against third parties

Insolvency of the principal debtor or the adoption of a restructuring plan (*dwangakkoord*) in bankruptcy under the Dutch Bankruptcy Act does not affect creditor rights against third parties, such as sureties.[79] Furthermore, if the creditor is protected by both *in rem* (e.g. mortgage, pledge) and a personal security right (i.e. suretyship), it is generally up to the creditor to choose whether to enforce his right of pledge or mortgage or to call upon the surety.[80]

First, the above rules reflect the nature and economic function of suretyship and solidarity relationships, which serve to safeguard a creditor against the consequences of insolvency or default of the principal debtor or one of the co-debtors. Should the liberating effect of insolvency be extended to a surety, suretyship (being a personal security right) would lose its protective function at the time when it is most needed.[81] Second, Dutch law is based on the recognition that a plan (*dwangakkoord*) adopted under the Dutch Bankruptcy Act is accepted by creditors not to relinquish their rights or to make a gift, but to obtain as much as possible under the given circumstances.[82] For this reason too, sureties and co-debtors cannot invoke the plan for their release. The same rule applies, in principle, to WHOA schemes.[83] Therefore, sureties and co-debtors cannot invoke a WHOA scheme as a ground for the

79 Dutch Bankruptcy Act, Article 160. A surety is a party that has committed itself to one or more creditors to fulfil the obligations of the principal debtor towards such creditors. See Article 7:850 BW. Suretyship is a form of joint and several liability. For this reason, Article 7:850(3) BW stipulates that the provisions regarding joint and several liability apply to suretyship, insofar as this title (that is, Title 14 of Book 7 BW) does not deviate from them.

80 HR 24 April 1992, *NJ* 1992/463 (*Heidenreich/Alcredis Bank NV*) and Conclusie AG Hartkamp, nr. 6. However, if a creditor's claim is secured, it may be contrary to the standards of reasonableness and fairness if the creditor first sues the surety before attempting to enforce security rights. Therefore, in certain circumstances, a creditor may be required to first enforce his other security rights before calling on the surety. Asser/Van Schaick 7-VIII 2018/84. Also under Article 3:234(1) BW, "[i]f both the debtor's and third party's property has been pledged or mortgaged for the same claim, the third party may, when the creditor proceeds to foreclosure, demand that the debtor's assets be included in the sale and that they be sold first." A surety lacks such legal privilege of enforcement. G.J.L. Bergervoet, Borgtocht (O&R nr. 84) 2014, 6.2.2.

81 MvT, Bijlagen Handelingen II 1890/91, 100, 3, p. 61; Kortmann/Faber, Geschiedenis van de Faillissementswet, heruitgave Van der Feltz, II, Wolters Kluwer, 2016, p. 189.

82 Ibid. Note that the adoption of plans (*dwangakkoord*) in bankruptcy is rather rare in practice. In 2015, only 1.7% of declared bankruptcy cases ended by means of a plan. CBS, Faillissementen, oorzaken en schulden 2015, p. 18.

83 Dutch Bankruptcy Act, Article 370(2), stating that Article 160 applies *mutatis mutandis*, unless a plan restructures group guarantees under Article 372(1). The provision prevents guarantees from being discharged after the plan has been approved. MvT, *Kamerstukken II* 2018/19, 35249, 3, p. 35.

discharge of their obligations,[84] unless the scheme includes a third-party release (see Chapter 10). The general rule is that a surety remains liable for the payment of the original claim, in the manner stipulated and at the time agreed before the WHOA scheme has been confirmed. This outcome is not contrary to the accessory character of the surety's liability (similar to the English law principle of co-extensiveness). The principal debtor remains liable notwithstanding the plan or scheme. Only enforceability of his obligations is affected. The residual claim continues to exist in the form of a natural obligation, regardless of whether this is stipulated in a plan and whether the debtor can pay the residual claim.[85]

However, similar to the approach of US law to non-bankruptcy settlements and English law to the effects of company and individual voluntary arrangements (CVAs and IVAs), under Dutch law, the outcome is different for out-of-court agreements or workouts. Pursuant to Article 6:160 BW, an obligation ceases to exist when the debtor and creditor enter into an agreement with each other in which the creditor waives his right to performance. In view of the dependent, accessory nature of suretyship, the cancellation or release of the main obligation in principle leads to the cancellation or discharge of the secondary obligation under the guarantee. This follows directly from Articles 6:160, 3:82 and 3:7 BW. In workouts, to which the ordinary rules of contract law apply, a creditor is free to accept the composition offered by the debtor. This is why a voluntary out-of-court agreement releasing the principal debtor, discharges the surety.[86]

6.5.2.3.2 Liability and contribution claims of co-sureties

As opposed to English and US law, under Dutch law, the release of one of the sureties by the creditor may have no effect on the liability of co-sureties. The reason for this is quite complicated and specific to Dutch law. It has to do with the fact that under Dutch law, the obligations of co-debtors (including co-sureties), while being joint and several to the creditor, are not necessarily interdependent (*afhankelijk*) as between each other.[87]

Let us first consider the case where the principal debtor is not insolvent, as insolvency affects and creates rights of a surety against other co-sureties (see below). The difference with English and US law arises from the fact that under Dutch law, sureties may have no claim for contribution from

84 Asser/Van Schaick 7-VIII 2018/93.

85 HR 31 January 1992, ECLI:NL:HR:1992:ZC0492, *NJ* 1992/686, m.nt. P. van Schilfgaarde (*Van der Hoeven/Comtu*).

86 Hof Leeuwarden 7 April 2009, ECLI:NL:GHLEE:2009:BI2399, *JOR* 2009/302, refusing to apply Article 160 Fw *mutatis mutandis* to an out-of-court agreement. The court noted that for a judicial composition (*akkoord*), the unpaid part of a claim is usually treated as a natural obligation (HR 31 January 1992, *NJ* 1992/686), whereas in the event of an out-of-court agreement, this is not the case.

87 W.H. van Boom, Hoofdelijke verbintenissen. W.E.J. Tjeenk Willink, 1999, p. 133.

co-sureties. This follows from the construction of Articles 6:10 and 6:12 BW, which provide for a right to contribution (*bijdragen*) only from co-debtors that are *draagplichtig*, which is the case where the debt concerns co-debtors (co-sureties) internally. One example of this is when two persons, acting as co-obligors, buy a car for their common use (i.e. common benefit).[88] If the co-debtors are *draagplichtig*, a contribution claim of each individual debtor is limited to the amount that they owe in their internal relationship, their internal share.[89] This can be compared to a "contributive share" mentioned in the previous section on US law. In other words, the paying debtor can only sue other debtors for the amount for which the debt concerns each of them internally. Whether and to what extent there is a right to contribution from co-debtors thus depends on their internal burden-sharing, a mutual internal relationship, as distinguished from an external relationship, a relationship with the creditor.[90] If such an internal relationship is not present (and there is no general presumption of its existence in law), no right to contribution arises. This is the key difference with English and US law.

In a standard (non-group) situation, co-sureties are not considered *draagplichtig* because the debt does not concern them internally.[91] As a result, Articles 6:10 and 6:12 BW would not entitle them to claim contribution from one another. In practice, however, it might be difficult to ascertain whether there is an internal relationship that gives rise to a contribution claim between co-sureties. The first step is to check whether the parties may have expressly agreed on an internal obligation to contribute (*draagplichtovereenkomst*).[92] Particular problems arise in a group financing context, where several group members benefit, directly and/or indirectly, in their internal relationships.

Imagine a typical case where one entity within the group acts as a borrower and other group entities provide guarantees, subsequently benefitting from the loan via intra-group loans (e.g. the cases of Lehman Brothers and Oi Brazil). Based on the facts of the case, it is possible to argue that there is an obligation to contribute between group entities acting as joint and severally liable debtors to the extent or in the share that each of them benefited from group financing. For example, this could be determined by looking at which group entity used the borrowed money or at whose disposal the loan was made – a cash-flow based test. This conclusion follows from *Janssen/*

88 Asser/Sieburgh 6-I 2020/122.

89 Dutch Civil Code, Article 6:10(2). G.J.L. Bergervoet, Borgtocht (Onderneming en recht nr. 84), Deventer: Kluwer 2014, 3.2.6.

90 J. den Hoed, GS Verbintenissenrecht, commentaar op art. 6:10 BW.

91 Asser/Sieburgh 6-I 2020/122.

92 C.H.A. van Oostrum, Regres bij concernfinanciering (Serie Van der Heijden Instituut nr. 156) (diss. Leiden), Deventer: Wolters Kluwer 2019, 7.2.1.0, noting that these agreements are uncommon and arguing that even when they exist, they may not necessarily reflect the actual relations between the parties at the relevant time.

JVS Beheer.[93] Arguably, in an integrated corporate group, it is difficult to unravel financial flows between group entities to determine which specific entity derived profit and in what amount – an important step that needs to be undertaken to calculate an internal share.[94] Therefore, the existence and scope of contribution claims between group companies may be somewhat uncertain. In a more recent decision, the Dutch Supreme Court clarified that in a group context, when deciding on the internal obligation to contribute between group members, the court may also consider direct and indirect benefits of financing for the group members.[95] Hence, indirect benefits and other relevant circumstances can be part of judicial assessment. This is a step forward in the legal development. Yet it does not offer much guidance to courts regarding specific facts or patters which can assist them in carrying out such an assessment.

Outside insolvency, co-sureties and other jointly and severally liable debtors who are not liable in their internal relationship (*niet draagplichtig*), do not have to share their burden with each other.[96] This is different from English law, where co-suretyship creates a common burden that needs to be borne equitably by all co-sureties.

The situation is very different when the joint and several debtor, not liable in its internal relationship with other co-debtors, cannot recover from the principal debtor or from co-debtors with an internal obligation to contribute. This situation arises if the principal debtor is insolvent and cannot fully satisfy the surety's claim.[97] In a situation like this, Dutch law confers the right to contribution on a paying debtor against its co-debtors (Article 6:13(2) BW), and on a paying surety against co-sureties (Article 7:869 BW), even if these co-debtors and co-sureties are not internally liable.[98] The loss is

93 HR 13 July 2012, ECLI:NL:HR:2012:BW4206, *NJ* 2012/447 (*Janssen q.q./JVS Beheer*). The alternative approach argues that, in the absence of a *draagplichtovereenkomst*, the starting point should be that group entities are internally liable in equal parts, under the principle of *solidariteit*. See H.P.J. Ophof, Hoofdelijke aansprakelijkheid: solidariteit of apartheid? (Inaugurele rede Vrije Universiteit Amsterdam), Deventer: Kluwer 1987, p. 10-13. However, following *Janssen q.q./JVS Beheer*, the point of departure is different, namely the determination of which entity has used or had access to the line of credit.

94 S.M. Bartman, annotatie bij HR 13 juli 2012, ECLI:NL:HR:2012:BW4206, Ars Aequi 2012, p. 833 (*Janssen q.q./JVS Beheer*).

95 HR 24 February 2023, ECLI:NL:HR:2023:295, r.o. 3.5.

96 Asser/Sieburgh 6-I 2020/122.

97 If there are two or more joint and several debtors (co-debtors), and if the suretyship covers both their debts, the surety can claim contribution from each of them in full, and not only the part of the debt that concerns each debtor, irrespective of debtors' internal relationships (Article 7:866(3) BW). This is an explicit derogation from Article 6:10 BW, pursuant to which a joint and several debtor can only hold other debtors liable for the part of the debt that each debtor had to bear in their internal relationship.

98 For the analysis of the rules on joint and several liability and rules applicable to suretyship, see C.J.M. Klaassen, Hoofdelijkheid ofborgtocht, wat zal het wezen? WPNR 1998/6316, p. 347-351.

shared among them in proportion to the amounts for which they could have been held liable by the creditor.[99] The right of contribution under Articles 6:13(2) and 7:869 BW has a subsidiary character.[100] As a result, in practice, if the principal debtor is insolvent, cannot be traced, or if his assets cannot be recovered to satisfy the recourse claim for any other reason, Dutch law might not be that different from English or US law. As the right of contribution arises only if the debt cannot be recovered from *draagplichtige* debtor(s), a surety can be effectively forced to first go against this debtor(s), and only then seek recovery from non-*draagplichtige* co-sureties. To conclude this section, ultimately each surety bears the risk of the principal debtor's insolvency, although the risk exposure may be limited by the scope or amount for which the surety has been provided.

6.5.2.3.3 Intra-group liability and 403-statements

The discussion of intra-group liability arrangements in Dutch law would be incomplete without covering intra-group liability arising from a 403-statement (*403-verklaring*). Pursuant to Article 2:403 BW,[101] a group entity may be exempted from an obligation to prepare and publish annual accounts. There may be various reasons to opt for this special regime. It reduces the regulatory burden within the group and prevents competitors from becoming aware of the financial results and capital positions of individual group entities.[102]

However, there are a number of requirements. For example, information normally included in annual accounts (e.g. assets, liabilities, income, expenses) must be consolidated in the annual accounts of the group company, typically a parent company.[103] Crucially, this company shall declare in writing that it makes itself jointly and severally liable for debts arising from legal acts of other group entities, typically subsidiaries, whose accounts are being consolidated.[104] The statement to this effect, a 403-statement, should be deposited at the Chamber of Commerce (*handelsregister*).[105] The joint

99 Asser/Sieburgh 6-II 2021/287.

100 Asser/Van Schaick 7-VIII 2018/124.

101 This arrangement follows the Fourth Council Directive 78/660/EEC of 25 July 1978 based on Article 54 (3) (g) of the Treaty on the annual accounts of certain types of companies (Article 57), repealed by the Directive 2013/34/EU of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings (Article 37).

102 Asser/Maeijer & Kroeze 2-I* 2015/581; J. van der Kraan, Toepassing en rechtskarakter van de groepsvrijstelling van artikel 2:403 BW (Serie Van der Heijden Instituut nr. 171), Deventer: Wolters Kluwer 2022.

103 Dutch Civil Code, Article 2:403(1)(c).

104 Dutch Civil Code, Article 2:403(1)(f). The requirement that liability must arise from legal acts (*rechtshandelingen*) excludes from the scope of 403-statement liability in tort. E.D.G. Kiersch, in: T&C Burgerlijk Wetboek, commentaar op art. 2:403 BW.

105 Dutch Civil Code, Article 2:403(1)(g).

and several liability is solely based on the 403-statement.[106] The purpose of this statement is to give protection to creditors of a group entity (e.g. a subsidiary) since such creditors – as a result of the exemption under Article 2:403 BW – cannot base their decision on whether or not to contract with the subsidiary on its annual accounts. The economic effect of a 403-statement is similar to a parent company guaranteeing debts of its subsidiaries. If the subsidiary does not pay, its creditors can go against the parent company. However, while a guarantee is commonly addressed to a specific creditor, a 403-statement is a unilateral legal act (not a contractual relationship), not addressed to any specific party, on the basis of which direct liability of the (parent) company arises.[107]

The BW does not establish specific content or consequences of a 403-claim. For example, if the claim of the creditor against the subsidiary is privileged, should it also have priority when filed against the parent? The Dutch Supreme Court clarified in this respect that any privileges attached to the original claim do not pass to the claim based on a 403-statement.[108] The court reasoned that the privileges could only arise from the law (Article 3:278(2) BW) and that neither Article 2:403 nor any other statutory provision attached a privilege to the claim based on a 403-statement. In another case, the court ruled that the subordinated status of a claim against the subsidiary did not lead to the subordination of a 403-statement-based claim against the parent company.[109] It stated that contractual subordination (Article 3:277(2) BW) was not a property of the obligation itself but constituted a deviation from the main (*pari passu*) rule, as applied to recovery from assets of a debtor that agreed to such subordination.[110] Thus, a subordination clause in the agreement between a creditor and a subsidiary has no influence on that creditor's recovery from assets of a third party (parent) that is jointly and severally liable for the obligation by virtue of a 403-statement and that is not a party to the subordination clause.

---

106 HR 28 June 2002, ECLI:NL:HR:2002:AE4663, *NJ* 2002/447, m.nt. J.M.M. Maeijer; *JOR* 2002/136, m.nt. S.M. Bartman (*Akzo Nobel/ING*).

107 There are other key differences between joint and several liability arising from a guarantee and a 403-statement, inter alia, regarding the consequences of a voluntary release. As noted above, a voluntary release of the principal debtor typically discharges the surety. In contrast, the release by the creditor of the subsidiary does not necessarily lead to a discharge of the parent company, liable under a 403-statement. This follows from the fact that a unilateral declaration of joint and several liability under a 403-statement does not create a dependent right in the sense of Articles 3:7 and 3:82 BW. HR 28 June 2002, ECLI:NL:HR:2002:AE4663, *NJ* 2002/447, m.nt. J.M.M. Maeijer (*Akzo Nobel/ING*).

108 HR 11 April 2014, ECLI:NL:HR:2014:898 (*X / Curatoren Econcern N.V.*) and ECLI:NL:HR:HR:2014:904 (*UWV / Curatoren Econcern N.V.*).

109 HR 20 March 2015, ECLI:NL:HR:2015:661, *NJ* 2015/361, m.nt. J.W. Winter en P. van Schilfgaarde (*Minister van Financiën / Vereniging VEB NCVB, Stichting Beheer SNS Reaal e.a.*).

110 Ibid., r.o. 4.34.4.

Liability under a 403-statement is different from a suretyship agreement when it comes to its withdrawal. The law provides that a 403-statement can be withdrawn by filing a statement to that effect with the *handelsregister*.[111] No liability can arise for legal acts after the day on which the revocation statement is filed, or from a later date if specified in the revocation statement. Nevertheless, the parent company remains liable for debts derived from legal acts predating the revocation.[112] This residual liability can be terminated if the subsidiary leaves the group, for example as a result of a sale or because there is no longer a group in the sense of Article 2:24b BW.[113] When this occurs, a creditor has a two-month period to oppose the termination of residual liability. The creditor can demand from the parent company that, "in exchange" for termination of residual liability, it is given a personal or *in rem* security.[114] Yet the creditor is not entitled to such security if his position is sufficiently protected considering the financial strength of the subsidiary.

6.5.3 Performance by a guarantor and its rights against the principal debtor

6.5.3.1 The UK: subrogation and indemnification claims in insolvency proceedings and in schemes of arrangement

Under English law, if the guarantee is provided at the request of the principal debtor, whether expressed or implied, the guarantor acquires the right to be indemnified by such a debtor for payments made under the guarantee.[115] The *indemnification claim* – a claim for the payment of debt – is "distinct from any of the creditor's rights against the debtor that it may exercise by subrogation."[116] The right to an indemnity is an independent right of the guarantor, separate from the right arising from subrogation (see below). As a result of this independent nature of an indemnity claim, any action taken by the creditor without the cooperation of the guarantor (e.g. an agreement not to sue the debtor or a compromise with the debtor) cannot prejudice the guarantor.[117] The independent nature of a right to indemnity also means

111 Dutch Civil Code, Article 2:404(1).
112 Dutch Civil Code, Article 2:404(2).
113 E. Nass, GS Rechtspersonen, commentaar op art. 2:403 BW. The rules on termination of residual liability can be found in Article 2:404(3)-(6) BW.
114 E.A. van Dooren, De aansprakelijkheid op grond van een 403-verklaring (diss.), Uitgaven vanwege het instituut voor Ondernemingsrecht nr. 122, Deventer: Wolters Kluwer, 2021, 8.9ff.
115 R. Goode, L. Gullifer, Goode and Gullifer on Legal Problems of Credit and Security, 6th edn, Sweet & Maxwell, 2017, para. 8-11.
116 J. Phillips, J. O'Donovan, W. Courtney, Philips and O'Donovan: Modern Contract of Guarantee, 4th edn, Sweet & Maxwell, 2020, para. 12-031.
117 G. Andrews, R. Millett, Law of Guarantees, 7th edn, Sweet & Maxwell, 2015, para. 10-001.

that, in the absence of an agreement to the contrary, a limitation period does not start to run against the guarantor until it has paid the creditor.[118]

Alongside the right of indemnity, there exists an equitable remedy of *subrogation*, a remedy against the party who would otherwise be unjustly enriched.[119] Subrogation arises from the relationship of a guarantor and creditor itself. When a guarantor pays the guaranteed debt in full, it becomes subrogated to the rights of the creditor, both in equity and under s. 5 of the Mercantile Law Amendment Act 1856.[120] In other words, the guarantor steps into the shoes of the creditor and assumes the latter's legal position and rights against another person, such as the principal debtor.[121] This means that: (i) the creditor is accountable to the guarantor for any further payments received from the debtor; (ii) the guarantor succeeds to security rights held by the creditor; and (iii) to the extent to which the creditor was a preferential creditor, the guarantor becomes a preferential creditor as well.[122] Additionally, unlike an indemnity claim, the enforceability of subrogation rights is governed by the limitation rules that apply to the creditor's right of action.[123]

---

118 *Collinge v Heywood* (1839) 9 Ad. & El. 633; *Re Mitchell* [1913] 1 Ch. 201; *Re A Debtor* [1937] Ch. 156.

119 *Banque Financière De La Cité v Parc (Battersea) Ltd* [1999] 1 A.C. 221, 236.

120 The exclusion in common law of subrogation for partial performance aims to protect the creditor (*nemo subrogat contra se*). See S. Meier, Recourse between Solidary Debtors, in N. Jansen, R. Zimmermann (eds), Commentaries on European Contract Laws, OUP, 2018, p. 1585, observing that while some civil law jurisdictions allow a partial subrogation, they provide for creditor preference. Notably, before 1992, Dutch law provided for the subordination of a subrogated party outside insolvency. However, this rule was subsequently dropped. See HR 1 February 2008, *JOR* 2008/115 (*ING/Provincie Utrecht*). Thus, the current law prescribes the subordination of a subrogated party in insolvency, whereas subordination outside insolvency was abandoned by the legislator.

121 See, however, C. Mitchell and S. Watterson, Subrogation: Law and Practice, OUP, 2007, para. 3.15, noting that under subrogation, "the claimant is given new rights which replicate the creditor's extinguished rights."

122 R. Goode, L. Gullifer, Goode and Gullifer on Legal Problems of Credit and Security, 6th edn, Sweet & Maxwell, 2017, para. 8-25; J. Phillips, J. O'Donovan, W. Courtney, Philips and O'Donovan: Modern Contract of Guarantee, 4th edn, Sweet & Maxwell, 2020, para. 12-254.

123 J. Phillips, J. O'Donovan, W. Courtney, Philips and O'Donovan: Modern Contract of Guarantee, 4th edn, Sweet & Maxwell, 2020, para. 12-280. See, however, C. Mitchell, S. Watterson, Subrogation: Law and Practice, OUP, 2007, paras. 7.137-7.162, calling this approach "parasitic", criticising it, and proposing an alternative, "autonomous" approach.

In English law, there is a long-standing rule against double-proof concerning the same debt.[124] The essence of this rule is that "the insolvent estate should not be compelled to entertain more than one proof in respect of the same debt, for to do so would unfairly distort the *pari passu* principle of distribution in insolvency."[125] This means that the surety cannot prove its right against the principal debtor (whether on the basis of indemnity or subrogation) until the creditor has received full payment, unless the guarantor is responsible for a specified part of the debt, in which case upon payment of that part, the guarantor becomes entitled to lodge a proof for the sum paid.[126] The creditor's priority under the rule against double proof is often reinforced by a non-competition clause, excluding the guarantor's right to claim, prove, or rank together or in competition with the creditor.[127] If the principal debtor is discharged upon the completion of the insolvency proceedings, and the creditor's claim has not been satisfied in full, the guarantor's claim against the principal debtor remains unenforceable.[128] Importantly, the sums received from the guarantor, before or after the debtor's insolvency, do not have to be deducted from the amount claimed by the creditor in the insolvency of the principal debtor, as long as the creditor does not receive more than the total amount of its claim (hotchpot rule).[129] The rule against double-proof does not prevent a double proof of the same debt against separate estates ("double-dip"), which happens if the creditor sues simultaneously the principal debtor and the guarantor, co-debtors or co-surety.

As mentioned earlier, restructuring of the principal debt through a scheme of arrangement or a Part 26A plan does not discharge the guarantor. The creditor can successfully proceed against the guarantor, and unless the guarantor's rights of indemnity and subrogation are expressly limited or excluded by agreement,[130] the guarantor can then recover from the principal debtor any amount the guarantor paid the creditor. This right rests on the surety's equity not to have the whole burden of debt thrown upon him. Thus, it is in the interests of the principal debtor to propose a scheme of arrangement or a restructuring plan that provide a complete release of

124 *Re Fenton* [1931] 1 Ch. 85; *Re Polly Peck International Plc, In administration (No.3)* [1996] 1 B.C.L.C. 428; *Re Kaupthing, Singer & Friedlander* [2012] 1 A.C. 804, at 11; *Re MF Global UK Ltd (In Special Administration), Heis v. Attestor Master Fund LP* [2014] 1 W.L.R. 1558, at 72-78.

125 G. Andrews, R. Millett, Law of Guarantees, 7th edn, Sweet & Maxwell, 2015, para. 13-002.

126 *Cattles Plc v. Welcome Financial Services Ltd* [2010] 2 Lloyd's Rep. 514 per Lloyd LJ at 25.

127 Ibid., where the clause also protected the principal lender from competition from intercompany debts.

128 G. Andrews, R. Millett, Law of Guarantees, 7th edn, Sweet & Maxwell, 2015, para. 13-007.

129 R. Goode, L. Gullifer, Goode and Gullifer on Legal Problems of Credit and Security, 6th edn, Sweet & Maxwell, 2017, para. 8-18; I. Fletcher, Law of Insolvency, Sweet & Maxwell, 2017, para. 9-042.

130 J. Phillips, J. O'Donovan, W. Courtney, Philips and O'Donovan: Modern Contract of Guarantee, 4th edn, Sweet & Maxwell, 2020, paras. 12-017 and 12-260. *Highbury Pension Fund Management Co v. Zirfin Investments Ltd* [2013] EWCA Civ 1283; [2014] Ch. 359 at 5-6.

liabilities, including those based on indemnity or contribution rights of a guarantor or co-debtor. Payne observes that releasing the creditor's rights against third parties (e.g. guarantors) via a scheme is "entirely sensible. She explains that if a claim is pursued under a guarantee, it would lead to a subrogation claim by the guarantor against the company as the principal debtor, thereby defeating the purpose of the compromise between the company and the creditor.[131] Yet the indemnity claim may be more problematic, because subrogation only places the guarantor in the position of the creditor. By contrast, upon payment to the creditor, the guarantor might be entitled to claim the entire amount from the principal debtor under its right of indemnity, as if no compromise of the creditor's claim was effected via the scheme.[132] This could render the success of the scheme illusory from the principal debtor's perspective.

6.5.3.2 The USA: reimbursement, subrogation and bankruptcy subordination

US law contains a number of remedies available to a surety in its relations with the principal debtor. They include exoneration, reimbursement, and subrogation. While these remedies are grounded in equity, certain US states also regulate them through statutes.[133] Additionally, it is common for a surety to require the principal debtor to agree on an indemnity, whereby the debtor commits to indemnify the surety for any losses arising from the principal debtor's failure to fulfil underlying obligations.[134]

The *right of exoneration* is the right of a surety to demand performance from the principal debtor, as long as doing so does not prejudice the creditor. It is based on the belief that it is the principal obligor, who should perform and bear the cost of performance.[135] For the right of exoneration to arise, the principal obligor needs to be aware of the secondary obligor's identity or existence. Without such notice, a surety does not have the right to insist on performance by the principal debtor.[136] If proper notice was given, the surety may ask the court to compel the principal debtor to perform when due, so that it himself does not have to perform and seek reimbursement afterwards. In equity, a surety could also file a bill of *quia timet* (from Latin "because he fears") to compel his principal to perform, when he feared that the principal was going to dissipate assets that could be used to pay the creditor.[137]

---

131 J. Payne, Schemes of Arrangement: Theory, Structure and Operation, CUP, 2014, p. 24.
132 *Colouroz Investment 2 LLC & Ors, Re* [2020] EWHC 1864 (Ch), 2020 WL 03964188, at 72.
133 See Cal. Civ. Code § 2846, under which a "surety may compel his principal to perform the obligation when due." See also Ohio Rev. Code § 1341.19.
134 T. Eisenberg (ed.), Debtor-Creditor Law, Matthew Bender & Company, Inc., 2022, § 45.03.
135 Restatement 3d, Suretyship and Guaranty, § 21, comm. a.
136 P.A. Alces, The Law of Suretyship and Guarantee, Thomson Reuters, 2021, § 6.5.
137 T. Eisenberg (ed), Debtor-Creditor Law, Matthew Bender & Company, Inc., 2022, § 45.07.

A surety has the *right to reimbursement* from the principal debtor upon satisfying an underlying obligation, either in part or in full. This equitable remedy arises from an implied contract and has been incorporated into the statutes of several US states.[138] This right arises when the surety makes partial or complete payment and can only be enforced after the underlying obligation becomes due.[139] Just like the right of exoneration, the right to reimbursement requires a notice of the secondary obligation. Without such notice, there is no implied contract. This does not mean that the paying surety is left without any means to protect himself. After paying the creditor, the surety is entitled to claim restitution from the principal debtor to the extent of the latter's unjust enrichment.[140] It is important to emphasise that the right to reimbursement is based on the (implied) promise by the principal debtor. When the surety pays the debt of the principal debtor, an entirely new obligation of that debtor to reimburse the surety arises.[141] This distinguishes the right to reimbursement from that of subrogation, just as English law distinguishes between indemnity and subrogation.

Once a surety has completely fulfilled the secondary obligation, he is subrogated to the rights that the creditor had pursuant to the underlying obligation. *Subrogation* is broadly defined as "the substitution of another person in the place of the creditor to whose rights he succeeds in relation to the debt."[142] US law recognises two types of subrogation: (i) conventional subrogation, which is based on an agreement, and (ii) equitable subrogation, which arises as a matter of equity and is not dependent on a contractual relationship.[143] There are several features that distinguish subrogation from reimbursement.

First, the right of equitable subrogation exists as a matter of law rather than by an (implied) consent of the parties.[144] Some US states provide for the right of subrogation by statute.[145] Second, for the right to subrogation to arise, an underlying obligation must be satisfied in full,[146] whereas the right to reimbursement can arise from partial performance. Third, as a result of

138 See e.g. La. Civ Code, Art. 3049; Ga. Code § 10-7-41; Rev. Stat. Mo. § 433.070; N.D. Cent. Code, § 22-03-10.

139 P.A. Alces, The Law of Suretyship and Guarantee, Thomson Reuters, 2021, § 6.13. La. Civ. Code, Art. 3049; Restatement 3d, Suretyship and Guaranty, § 22, comm. d.

140 Restatement 3d, Suretyship and Guaranty, § 22, comm. a, and § 26.

141 T. Eisenberg (ed), Debtor-Creditor Law, Matthew Bender & Company, Inc., 2022, § 45.07.

142 *Hanover Ins. Co. v. Corrpro Cos., Inc.*, 312 F. Supp. 2d 816, 818 (E.D. Va. 2004).

143 T. Eisenberg (ed), Debtor-Creditor Law, Matthew Bender & Company, Inc., 2022, § 45.07.

144 *In re Cone Constructors, Inc.*, 265 B.R. 302, 303 (Bankr. Ct. M.D. Fla. 2001), holding that "equitable subrogation is a legal fiction which arises by operation of law."

145 See e.g. Cal. Civ. Code § 2848; La. Civ. Code, Art. 3048 ("The surety who pays the principal obligation is subrogated by operation of law to the rights of the creditor."); Ala. Code § 8-3-11; Va. Code § 49-27; Ga. Code § 10-7-56; Minn. Stat. § 574.16.

146 Restatement 3d, Suretyship and Guaranty, § 27. *Nova Info. Sys., Inc. v. Greenwich Ins. Co.*, 365 F.3d 996 (11th Cir. 2004).

subrogation, a surety succeeds to the rights of the creditor in relation to the debt or claim, and its rights, remedies, or securities.[147] Since the underlying obligation has been fully satisfied, allowing the surety to enforce the creditor's rights does not harm the interests of the creditor.[148] By contrast, the right to reimbursement – which, as noted above, may arise from partial satisfaction – does not provide the surety with the creditor's rights concerning the underlying obligation. In other words, the right to reimbursement is a general claim with no priority over other claims except by agreement. Fourth, when enforcing the creditor's right by subrogation, the surety is subject to the statute of limitations that applies to the creditor's claim. Conversely, since the right to reimbursement is an independent cause of action, it is subject to a different statute of limitations that starts running upon the performance of the secondary obligation.[149]

The preceding paragraphs described the rights of parties outside insolvency. Reflecting on the rights and remedies of a surety in a situation where the principal debtor is insolvent, Downs observed that "[a]ny surety who has had an occasion to attempt to enforce the Bankruptcy Act [now the Bankruptcy Code] will realize why a citation of authorities would be the equivalent of entering battle with a belt filled with blank cartridges."[150] Bankruptcy law interferes with parties' contractual or equitable rights. Two sections of the US Bankruptcy Code are of relevance here, namely sections 502 and 509.

Section 502(e) in certain circumstances requires the disallowance of indemnity, reimbursement and contribution claims "of an entity that is liable with the debtor on or has secured the claim of a creditor." As in English law, the general idea is that the claims of a guarantor, surety or co-debtor should not be allowed to compete with the creditor's claim on the "limited proceeds in the estate."[151] There should only be one recovery on the basis of the same debt. Therefore, if the claim for reimbursement or contribution is contingent, it will be disallowed.[152] Collier on Bankruptcy further explains that by "disallowing the guarantor's contingent claim for reimbursement or contribution, [the law] ensures that the estate will not at the same time be liable to the primary obligor and the guarantor for the same debt."[153] However, if

147 Restatement 3d, Suretyship and Guaranty, § 28, comm. a, explaining that "by giving the secondary obligor the equivalent of an assignment of the [creditor's] rights, the law […] effectuates the goal of causing the principal obligor to bear the cost of performance."

148 Restatement 3d, Suretyship and Guaranty, § 27, comm. a. P.A. Alces, The Law of Suretyship and Guarantee, Thomson Reuters, 2021, § 6.28.

149 Restatement 3d, Suretyship and Guaranty, § 28, comm. c.

150 W. Downs, A Surety's Basic Rights and Remedies, Defense Lawyers Journal, Vol. 15, 1966, p. 172.

151 S. Rep. No. 95-989; H.R. Rep. No. 95-595, at 354.

152 11 U.S. Code § 502(e)(1)(B).

153 Collier on Bankruptcy, 16th edn, 2022, Vol. 4, ¶ 502.06[2][d].

a surety pays a portion of a claim during the case, that portion of the claim for reimbursement is no longer contingent (i.e. it becomes fixed) and may not be disallowed. In this respect, the approach of US law seems to be different from English law and its strong stance against double-proof. As noted earlier, English law does not allow the surety to prove for its claim against the principal debtor until the creditor has been paid in full. The practical effect of this difference, however, should not be overstated, because the US Bankruptcy Code contains a rule that *subordinates* the surety's claim to the claim of the creditor for the underlying obligation, until the surety fully satisfies such creditor's claim. This rule effectively grants priority to the creditor over the surety.

Section 509 provides that a surety who pays all or part of the claim post-petition is subrogated to the rights of the creditor to the extent of such payment.[154] While subrogation in common law and under state law typically requires the surety to have paid the underlying claim in full before asserting any rights, US bankruptcy law allows for subrogation to arise from partial payment of the creditor's claim.[155] Essentially, the surety steps into the creditor's shoes when the creditor is still wearing them. This peculiarly, however, is unlikely to have a significant effect on the outcome of the case, as, similar to claims for reimbursement or contribution, the subrogation claim is *subordinated* to the creditor's claim until the creditor is fully paid.

Section 509 also establishes that if the surety asserts its right of subrogation, the claims for reimbursement or contribution shall not be allowed.[156] The requirement for a surety to make a choice between these remedies seeks to avoid double recovery, one based on its own right and another by way of subrogation.[157] Logically, subrogation may be the preferred option if the creditor's claim is secured,[158] or if the payment under the guarantee is

154 11 U.S. Code § 509(a). Note that US courts refuse to extend § 509 and to grant subrogation rights to a party who is itself primarily liable on the creditor's claim. Collier on Bankruptcy, 16th edn, 2022, Vol. 4, ¶ 509.02.

155 *In re Cornmesser's Inc.*, 264 B.R. 159, 163 (Bankr. W.D. Pa. 2001); *In re LTC Holdings, Inc.*, 597 B.R. 565, 567 (Bankr. D. Del. 2019), noting that "[i]n a departure from common law, 11 U.S.C. § 509 permitted partial subrogation."

156 11 U.S. Code § 509(b)(1). *In re Fiesole Trading Corp.*, 315 B.R. 198 (Bankr. Ct. D. Mass. 2004); *In re Celotex Corp.*, 289 B.R. 460 (Bankr. M.D. Fla. 2003).

157 C.J. Tabb, Law of Bankruptcy, 4th edn, West Academic Publishing, 2016, p. 664.

158 *In re The Medicine Shoppe*, 210 B.R. 310, 313 (Bankr. N.D. Ill. 1997), holding that "Subrogation under § 509(a) allows a guarantor, who pays a debt for which a debtor is primarily liable, to assume the creditor's rights. These rights include any rights to priority distribution or secured status to which the subrogor's claim was entitled."

triggered by a post-petition breach of the principal debtor, giving rise to an administrative expense priority claim of the creditor.[159]

In sum, US law aims to achieve a fair allocation of the debtor's assets among various groups of competing claims in bankruptcy. Although a surety's claim for contribution, reimbursement, or subrogation (provided it is not contingent) may be allowed, the surety cannot partake in the distribution of the debtor's assets until the creditor's claim has been fully paid. This outcome is supported by specific rules on subordination, found in the US Bankruptcy Code. The practical effect of these rules is similar to what is accomplished under English law – the creditor goes first, without having to compete with a surety.

6.5.3.3 The Netherlands: contribution, subrogation and restructuring plans

A guarantor who has paid the creditor has a right of recourse against the principal debtor. This right can take the form of a right of contribution (*regresrecht*)[160] and a right of subrogation (*recht krachtens subrogatie*).[161]

The *right of contribution* is an independent right that is not derived from the creditor's position. It co-exists with subrogation, discussed below.[162] It aims to prevent the principal debtor from being unjustly enriched at the expense of the guarantor because the guarantor has paid the debt owed by the principal debtor to the creditor.[163] Due to the independent nature of the right to contribution, the paying guarantor does not succeed in the security and priority rights which may have been attached to the creditor's claim. This is different in case of subrogation, where – as in English and US law – a third party, such as a guarantor, takes place of the creditor and therefore benefits from the associated security and other ancillary rights and privileges.[164]

Another significant difference between a right of contribution and a right of subrogation concerns the application of the statute of limitations (*verjaring*) and, specifically, the time when it starts to run. The right of contribution is an *independent* right that only arises when a joint and several debtor makes a

---

159 *In re Wingspread Corp.*, 116 B.R. 915 (Bankr. S.D.N.Y. 1990). B.E. Greer, J.S. Moss and N.B. Herther-Spiro, Guarantees in Bankruptcy: A Primer II, Norton Annual Survey of Bankruptcy Law, 2014 edn, p. 171. Other types of priority may not be "assignable" to the surety's subrogation claim. See 11 U.S. Code § 507(d).

160 Dutch Civil Code, Articles 7:866 and 6:10. On *regresrechten* in general, see H.G.F.M. de Kok, Het regres (diss. Nijmegen), Deventer: Kluwer 1965.

161 Dutch Civil Code, Article 6:12.

162 J. den Hoed, GS Verbintenissenrecht, commentaar op art. 6:10 BW; Asser/Sieburgh 6-I 2020/132.

163 Castermans & Krans, in: T&C Burgerlijk Wetboek, commentaar op art. 7:866 BW.

164 Dutch Civil Code, Articles 3:7, 3:82, 6:142. Asser/Sieburgh 6-I 2020/133.

payment exceeding its share.[165] By contrast, a person with a right of *subrogation* "inherits" the rights of the creditor. Consequently, the debtor is able to raise all the defences against the subrogated party that it could have raised against the original creditor (Art. 6:145 BW), including the defence that the claim is time-barred.[166] This is also why the limitation period of the claim transferred by subrogation commences at the time the claim arose for the original creditor.[167]

In Dutch law, subrogation is understood to mean the transfer by operation of law of a claim to a person at whose expense the creditor has been paid.[168] This claim can be enforced against the debtor or several jointly and severally liable debtors.[169] A surety who pays the debt acquires a subrogation claim that can be exercised jointly and severally against co-debtors, regardless of whether such co-debtors are internally liable.[170] Subrogation is a consequence of payment. As noted above, subrogation and contribution claims are available to the paying guarantor concurrently. This means that a guarantor who has extinguished the debt is free to choose the grounds for recourse or rely on both grounds at the same time (note the difference with the US approach). At the same time, it should be noted that the guarantor's rights to contribution and subrogation are often excluded in a contract, preventing the paying guarantor from seeking recourse against the principal debtor. Such a waiver ensures that the creditor does not face competition from the guarantor's recourse claim.[171]

165 HR 6 April 2012, ECLI:NL:HR:2012:BU3784, *NJ* 2016/196, m.nt. C.E. du Perron; *JOR* 2014/172, m.nt. N.E.D. Faber & N.S.G.J. Vermunt (*ASR/Achmea*). R.J. van der Weijden, GS Verbintenissenrecht, commentaar op art. 6:150 BW, noting that before *ASR/Achmea*, some authors argued that the right of contribution existed conditionally at the time when joint and several liability was assumed. The Supreme Court in *ASR/Achmea* made it clear that this was not the case and that the right of contribution could only arise at the moment the guarantor or co-debtor paid the claim for more than the part that concerns him internally. Read further, W.H. van Boom, Het ontstaansmoment en de verjaring van de regresvordering, *Ars Aequi* 2013, p. 36-43; D.F.H. Stein, V. Tweehuysen & S.E. Bartels (red.), Verjaring, Deventer: Wolters Kluwer, 2020; D.F.H. Stein, Verjaring van wettelijke regresvorderingen en de 'afzonderlijke elementen-leer', AV&S 2020/26.

166 A.C. van Schaick, Het glibberige pad van de verjaring van de regresvordering, *NTBR* 2012/55, explaining that the subrogated party under the suretyship agreement exercises the creditor's claim and that this claim continues to be subject to the limitation period already applicable.

167 R.J. van der Weijden, GS Verbintenissenrecht, commentaar op art. 6:150 BW.

168 Asser/Sieburgh 6-I 2020/132; Asser/Sieburgh 6-II 2021/269.

169 Asser/Sieburgh 6-II 2021/284.

170 Dutch Civil Code, Article 7:866(3).

171 G.J.L. Bergervoet, Borgtocht (O&R nr. 84), Deventer: Kluwer 2014, 8.3.6. and 8.4.5. A surety can waive his right of recourse even if he is a consumer under Article 7:857 BW (*borgtocht, aangegaan buiten beroep of bedrijf*). See Article 7:866 BW.

What happens in insolvency? Under Dutch law, the guaranteed creditor can sue both the insolvent principal debtor and the guarantor for the full amount of the debt.[172] In insolvency proceedings, distributions are calculated based on the entire claim, although the creditor can never receive more than 100% of the claim. The amount of a claim is determined at the time of the insolvency order. Therefore, only payments received by the creditor prior to this point should be deducted from the claim. If partial satisfaction of a claim occurs after the initiation of insolvency proceedings (e.g. partial payment by a guarantor or co-debtor), no such deduction occurs.[173] On this latter point, Dutch law is similar to English and US law.

Dutch insolvency law adopts a position similar to English law regarding the guarantor's right of recourse. As mentioned earlier, English law does not allow double proof – a situation where two or more persons (e.g. a creditor and a guarantor) file claims in proceedings of the principal debtor for the same debt. As a general rule, a guarantor can only claim in the insolvency of the principal debtor after satisfying the creditor's claim. The same outcome is achieved in the USA, where instead of disallowing recourse claims, bankruptcy law imposes special subordination rules (see section above).

Yet, as an exception to this general rule, according to Article 136(2) Fw, a recourse claim (i.e. contribution or subrogation) of the joint and several debtor (*hoofdelijke schuldenaar*), such as a guarantor, for amounts for which he has acquired or will acquire a claim against the principal debtor, can be – if necessary conditionally[174] – admitted in insolvency proceedings of the principal debtor, but only in three specific circumstances. These include cases where: (i) the creditor himself may not submit a claim or, although he is entitled to do so, does not submit a claim in the insolvency proceedings of the principal debtor;[175] (ii) the creditor receives full payment of its claim

172 Dutch Bankruptcy Act, Article 136.

173 Article 136 Fw constitutes an exception to the basic principle of Article 6:7(2) BW, according to which a fulfilment of the joint obligation by one of the co-debtors discharges other co-debtors. See A. Jonkers, Insider guarantees in corporate finance: An economic analysis of Dutch, US and German law, PhD thesis, 2020, p. 156, explaining that the reason for this exception is simplicity. Without it, any payments on the guaranteed debt made after the date of insolvency would have to be taken into account.

174 Conditional admission appears to apply to both the claim itself and the conditions of Article 136(2)(a-c) Fw.

175 This section of the article may apply if the creditor has been paid in full before insolvency or where it has waived its claim against the insolvent debtor. J.M. Hummelen, GS Faillissementswet, commentaar op art. 136 Fw, aant. 5. Such a waiver does not preclude recourse against the insolvent principal debtor (Article 6:14 BW). The creditor can also decide not to bother filing its claim against the debtor, as it can claim the full payment from the guarantor.

in insolvency proceedings;[176] or (iii) such an admission does not adversely affect unsecured creditors by introducing a competitive claim.[177]

As previously noted, if a creditor is involved in a restructuring plan (*dwangakkoord*) under the Dutch Bankruptcy Act, and if his rights against the principal debtor are affected by such a plan – meaning the enforceability of his claim is limited by the plan – as a general rule, the creditor retains the right to sue the guarantor for the amount of the original claim (Article 160 Fw). The question remains whether a guarantor is allowed to recover from the principal debtor the sums that it has paid to the guaranteed creditor after the WHOA plan has been approved. With respect to WHOA plans, the answer can be found in Article 370(2) Fw, under which if the creditor's claim is restructured via the WHOA plan, the guarantor cannot take recourse against the principal debtor to force it to pay the original debt in full. This provision is explicitly intended to prevent the debtor, after the plan has been homologated and the debtor has restructured its debts, from becoming insolvent due to the inability to pay recourse claims that arise after the plan confirmation.[178] The question is whether the outcome would be different if a recourse claim is secured. In a recent case, the court ruled that a secured creditor cannot claim recourse against the scheme debtor after the confirmation of the WHOA plan. It pointed out that the "fact that the bank [guarantor] has security for this recourse claim does not alter this. It does not matter in what way the redress is sought against the estate, the nature of the claim precludes it."[179]

176 F.M.J. Verstijlen, in: T&C Insolventierecht, commentaar op art. 136 Fw, providing an example where the creditor, who has already had a part of his claim paid by the co-debtor, would receive such a high percentage in the bankruptcy from the insolvent joint and several debtor that he would receive more than 100% of his claim.

177 J.M. Hummelen, GS Faillissementswet, commentaar op art. 136 Fw, offering an example where the recovery of the guarantor is on the basis of a security right not vested in the creditor. Under Dutch law, insolvency does not preclude the enforcement of an *in rem* security right by a secured creditor. See further section 11.2.3. of this book.

178 R. van den Sigtenhorst, in: T&C Insolventierecht, commentaar op art. 370 Fw. A similar position is taken in German insolvency law, which recognises that an insolvency plan can be jeopardised if a third party (e.g. guarantor) could take recourse against the principal debtor. This is why German law provides that the transformation of the substantive relationship between the principal debtor and its creditor under a restructuring plan also applies to the right of recourse against the principal debtor. See § 254(2) InsO. This means that the recourse claim follows the original claim in its reduced or extinguished scope.

179 Rb. Amsterdam 1 February 2023, ECLI:NL:RBAMS:2023:569, *JOR* 2023/83, m.nt. V.G. Koolen. The court addressed the bank's (guarantor's) argument that the refusal to allow the recourse claim constituted a violation of Art. 1 Protocol 1 of the ECHR (protection of property). The court observed that the Dutch legislator had deemed the infringement of the right of (in this case) the bank, as laid down in Art. 370(2) Fw, necessary for the public interest, to prevent the debtor from becoming insolvent after the homologation due to the enforcement of a recourse claim. It noted that it is up to the bank to demonstrate that, due to the concrete circumstances of this specific case, an infringement of property rights is disproportionate. In the court's view, such concrete circumstances have not been established, nor have they become apparent. Hence, the appeal to Art. 1 Protocol 1 of the ECHR fails. However, in our opinion, it may be disputed whether the differences in the outcomes for a guaranteed creditor in a bankruptcy proceeding and in a WHOA scheme are justified.

That said, if the payment by the guarantor results in the creditor receiving the full satisfaction of its original claim, the rights granted to the creditor in the plan are transferred by operation of law (subrogation) to the guarantor.[180] This is in line with the rule that a creditor should not receive more than 100% of his claim. For example, if pursuant to the WHOA plan, the creditor can only enforce his claim against the principal debtor for 40% of the original claim, and before such a claim for 40% has been enforced, the creditor can still claim 100% from the guarantor. If the guarantor pays the entire claim (100%), creditor's rights on the basis of the WHOA plan (i.e. claim that is only enforceable for 40%) are automatically transferred to the guarantor.

The rule of Article 370(2) Fw establishes a special regulation that deviates from the general rule to the extent that it affects the right of recourse by prescribing (i.e. limiting) circumstances in which it can be exercised and the determination of value that can be claimed. Whereas this special regulation applies to WHOA plans, it does not necessarily follow that the same approach is or should be taken in law with respect to a *dwangakkoord* (plan or composition) adopted in other procedures, namely in bankruptcy (*faillissement*) and suspension of payments (*surseance van betaling*). According to Article 160 Fw, despite such a plan, a guarantor remains liable for the full amount. With this in mind, the question is whether it is possible for the guarantor to claim a contribution from the principal debtor in an amount that exceeds the amount that the creditor is entitled to under the approved *dwangakkoord*?

No problem arises if we talk about the subrogation right, as the paying guarantor steps into the shoes of the creditor, so that his claim can only be enforced to the same extent as the creditor's claim is enforceable pursuant to the *dwangakkoord*. The right of contribution (*regres*) is different. Since the right of contribution is an independent right that is not derived from the position of the creditor, it cannot be affected by the *dwangakkoord* concluded before the contribution claim arises in the first place.[181] Given the absence

180 Dutch Bankruptcy Act, Article 370(2). MvT, *Kamerstukken II* 2018/19, 35249, 3, p. 10.

181 R. van den Sigtenhorst, Herstructurering van groepen onder de WHOA, in C.M. Harmsen & M.L.H. Reumers (red.), De WHOA van wet naar recht (Recht & Praktijk, nr. InsR18), Deventer: Wolters Kluwer 2021, 8.3.4., noting that "De WHOA-regeling is bijzonder, vanwege de uitsluiting van verhaal door garantiegevers op de WHOA-schuldenaar na eventueel verhaal op hen door schuldeisers die door het akkoord zijn geraakt: dit bestaat niet in faillissement en surseance." ("the WHOA scheme is special, because it excludes recourse by guarantors from the WHOA debtor after possible recovery from them by creditors who have been affected by the plan: the same does not apply in bankruptcy and suspension of payments." (translated by the author).

of a special rule to the contrary, it does not follow from Dutch law that any future contribution rights are affected by the *dwangakkoord* concluded in bankruptcy or suspension of payments. Thus, building on the case above, if the *dwangakkoord* concluded in bankruptcy reduces the creditor's claim to 40% of the original claim, the creditor can claim 100% from the guarantor. If the guarantor satisfies the creditor's claim in full, it acquires the right to claim the full amount (100%) from the principal debtor via a contribution claim.

6.6 Insolvency and Ex-post Effects of Cross-guarantees

This section summarises the effects of cross-guarantees on debtors' and creditors' behaviour in a situation of financial distress or insolvency (ex post effects). It appears that intercompany guarantees have certain features that might contribute to debtor and creditor opportunism, potentially compromising efficient group restructuring. Creditor opportunism is understood here in broad terms as the pursuit of economic self-interest by a creditor, even if such behaviour provokes negative side-effects on third parties and is therefore Pareto-inefficient.[182] These features are observed and explored through the lens of the relationships between group members and between non-guaranteed unsecured creditors and guaranteed creditors.

First, cross-guarantees intensify interdependence between group entities. In a crisis situation, they permit a group-wide enforcement action, allowing the guaranteed creditor to foreclose on assets of the principal debtor and of the guarantor(s), or force them into insolvency. The study of English, US and Dutch law exemplifies that a guaranteed creditor has wide discretion in the pursuit of his claim against the principal debtor, guarantor, or both at the same time. The latter results in the group-wide enforcement, whereby the full amount of debt is claimed from several group companies. The threat of such enforcement may compel the debtor's management to make selective payments in favour of the guaranteed creditor.[183] An insider-guarantor could also put pressure on the principal debtor to pay the guaranteed creditor first, indirectly profiting from such payment by limiting the exposure under the guarantee. The profit is, however, indirect, as the payment goes to

182 For discussion of the negative effects of creditor opportunism on economically efficient restructurings, see D. Ehmke, Publicly Offered Debt in the Shadow of Insolvency, EBOR, Vol. 16, 2015, pp. 63-96.

183 A. Jonkers, Selective Perforation by Means of Guarantees: Dutch Law, in The 800-Pound Gorilla. Limits to Group Structures and Asset Partitioning in Insolvency, NACIIL 2018 report, Eleven International Publishing, 2019, p. 75, noting that "intergroup guarantees can be seen as promises to the lender to make preferential payments, especially on the eve of bankruptcy."

a non-insider creditor and not to the guarantor.[184] If made in the vicinity of insolvency, these payments can amount to preferential treatment and breach the principle of equal treatment of creditors.

Second, cross-guarantees strengthen the position of a guaranteed creditor compared to other (unsecured) creditors, leading to a specific form of creditor governance and control.[185] In this context, an analogy can be drawn with the interests and incentives of creditors whose claims are secured by rights *in rem*. It is pointed out in the literature that secured creditors may prefer immediate debt enforcement over restructuring since the latter is naturally more unpredictable and riskier.[186] Garcimartín and Bermejo observe that secured creditors may be more interested in foreclosing the collateral and getting paid as soon as possible, even if this entails a fire sale that frustrates other options, more beneficial to unsecured creditors. They also argue that a secured creditor can be more concerned with maximising the value of the collateral over the value of the firm.[187]

Similarly, in a situation where, because of a cross-guarantee, the lender is interested in a quick "mass enforcement" against the estates of several group entities without bearing the downside risk of reorganisation, his position becomes analogous to that of a creditor over-insured on its loan. Just like the lender protected by collateral can dominate in insolvency

184 J. Gordon and R.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, Emory Bankruptcy Development Journal, Vol. 32, 2015, p. 76, whereby the benefit of the guarantor is termed a "phantom benefit".

185 K.M. Ayotte and E.R. Morrison, Creditor Control and Conflict in Chapter 11, Journal of Legal Analysis, Vol. 1, 2009, pp. 511-551; J.L. Westbrook, The Control of Wealth in Bankruptcy, Texas Law Review, Vol. 82, 2004, pp. 795-862.

186 C. Bergström, T. Eisenberg and S. Sundgren, Secured Debt and the Likelihood of Reorganization, International Review of Law and Economics, Vol. 21, 2002, p. 360, noting that "[s]ecured creditors receive only part of the gain if the value of the reorganized firm increases, but bear all of the costs if the value decreases." E.J. Janger, The Logic and Limits of Liens, University of Illinois Law Review, Vol. 2015, 2015, p. 592, stressing that the secured creditor control over governance in insolvency may "allow the secured creditor to capture a disproportionate share of bankruptcy-created value, or even prevent value maximizing reorganizations."

187 F. Garcimartín and N. Bermejo, Involving secured creditors in restructuring proceedings, in P.J. Omar and J.L.L. Gant (eds), Research Handbook on Corporate Restructuring, Edward Elgar Publishing, 2021, p. 122.

proceedings,[188] a guaranteed creditor might drive group-wide (pre-)insolvency dynamics. For such a creditor, the group-wide enforcement can be a way to withdraw his investment with minimal or no losses. For unsecured creditors, however, this enforcement may entail large costs, especially if it leads to a group disintegration.

Third, cross-guarantees complicate group restructurings. As demonstrated in the previous sections dealing with national law, the insolvency of the principal debtor typically has no effect on the creditor's rights against guarantors or co-debtors. Any other interpretation would result in the creditor losing its claim against both the principal debtor and guarantor, effectively undermining the essence or protective function of the guarantee relationship. The ability of a guaranteed creditor to go against the group guarantor can cause two problems:

- Under national law, a guarantor might be entitled to recover from the principal debtor the sums that he has paid to the creditor. This right of the guarantor may "survive" the approval of a restructuring plan, affecting the creditor's claim. Filing a ricochet claim by the guarantor against the restructured principal debtor in the full amount could undermine the effectiveness of the restructuring in the first place ("ricochet problem").
- The principal debtor may need the guarantor's assistance to implement the restructuring plan and to continue its business post-restructuring. The guarantor can be reluctant to contribute to the restructuring and extend assistance thereafter if it remains exposed to claims from the debtor's creditors. It might also be forced into insolvency or end up being sold to a competitor. As a result, given the group's interdependence, the restructured principal debtor can become an "orphan" with remote chances for long-term survival ("orphan restructuring problem").

188 The ever-increasing control by secured creditors over the insolvency process has been particularly emphasised in US literature. See D.G. Baird and R.K. Rasmussen, The End of Bankruptcy, Stanford Law Review, Vol. 55, 2002, pp. 751-789; D.A. Skeel, Creditors' Ball: The New Corporate Governance in Chapter 11, University of Pennsylvania Law Review, Vol. 152, 2003, p. 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."; R.K. Rasmussen, The end of bankruptcy revisited, in B.A. Adler (ed), Research Handbook on Corporate Bankruptcy Law, Edward Elgar Publishing, 2020, p. 42, listing among 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 the debtor's access to cash in his accounts.

Summarising the ex-post effects of cross-guarantees, it should be emphasised that they raise a number of red flags. They perforate limited liability, increase the correlation between different group entities, and can facilitate misalignment of creditors' interests, complicating the adoption of a group solution. The default of the principal debtor may cause a guaranteed creditor to launch the group-wide enforcement by filing the same claim against separate companies. As a result, the effectiveness of the debtor's restructuring may be threatened, especially in integrated groups where group entities depend on each other, and the failure of a single entity leads to a domino-like collapse of other group entities.

6.7 Conclusion

This chapter discusses cross-guarantees – one of the most common contractual arrangements accompanying the attraction of funds from outside lenders. It examines ex ante and ex post effects of group guarantees, looking at their economic rationale and impact on the agency cost of debt and access to finance, managerial behaviour, as well as the position and rights of guaranteed and non-guaranteed unsecured creditors.

A guarantee relationship serves an important protective and risk reduction function. As neatly pointed out by Wood, "[g]uarantees are usually taken to provide a second pocket to pay if the first should be empty."[189] In addition, the existence of a claim against several or all group entities makes the lender less exposed to risks arising from intra-group asset transfers. This additional security means that the borrower and the entire group may be financed on more advantageous terms. There are other good reasons for entering into cross-guarantees from both the creditor's and debtor's perspectives, inter alia, related to the value and marketability of bonds, exercise of set-off rights by a creditor, tax optimisation inside the group, etc. These reasons can be termed as reasons of (economic) ex ante efficiency.

Yet the web of cross-guarantees, often combined with intra-group loans, can cause significant problems in insolvency (ex post). Intercompany guarantees weaken protections granted by the doctrines of limited liability and entity shielding (see Chapter 2). These protections are traded for ex ante efficiency, as noted above. In a situation of insolvency, cross-guarantees may prompt the destruction of value as a result of simultaneous group-wide enforcement of the same debt. This may complicate group restructuring and lead to a collapse of the enterprise.

189 P. Wood, International Loans, Bonds, Guarantees, Legal Opinions, Sweet & Maxwell, 2007, para. 18-002.

This chapter examined the complex relationships between various parties involved in a typical group financing arrangement – "triangle of rights and liabilities": a principal debtor-borrower, a group guarantor (or co-guarantor) and a creditor-lender (guaranteed creditor). In all three jurisdictions studied in this book – the UK, the USA and the Netherlands – insolvency of the principal debtor per se does not affect the creditor's claim against the guarantor.[190] After all, it is the very purpose of the guarantee to protect the creditor against insolvency of the debtor. However, should the guarantor play a key role within the group and be forced into insolvency itself, the efficiency of the principal debtor's own restructuring and its long-term survival might be at risk – a problem coined as the "orphan restructuring problem". But this is not the only problem. Upon payment to the creditor, the guarantor may be entitled to file a claim against the principal debtor – a recourse claim. The legal basis (e.g. subrogation, contribution), availability, and amount of this claim depend on the applicable law and the type of proceeding in which the creditor's original claim is affected. For example, sanctioning of an English scheme of arrangement with respect to the principal debtor as such does not deprive the guarantor of its right to be compensated (indemnified) by such a debtor for the payments made pursuant to a guarantee.[191] Enforcement of this recourse claim can undermine the efficiency of restructuring proceedings – the "ricochet problem".

Both the ricochet problem and the orphan restructuring problem have led to the emergence of practices and rules that permit group debt deleveraging or group debt adjustment through so-called third-party releases. Third-party releases are discussed in Chapter 10.

190 The case of restructuring is less straightforward. In some cases, a semi-voluntary or purely voluntary alteration of the terms of the underlying agreement between the principal debtor and a creditor may affect the guarantor's obligations. Thus, unless the guarantor consents to be bound by the amended terms of the underlying obligation, a CVA or IVA under English law or an out-of-court agreement or workout under Dutch and US law might result in a complete or partial discharge of the guarantor.

191 By contrast, in the Netherlands, following the explicit statutory language, if the creditor's claim is restructured in the WHOA scheme of the principal debtor, the guarantor is prevented from taking a recourse against the principal debtor to force him to pay the original debt in full. The same result is achieved under US Chapter 11.

7 Intra-group Loans and Statutory Subordination▪

7.1 Introduction

The previous chapter discussed intra-group guarantees, which are used to attract financing from outside investors and financiers, or to secure better terms of such financing. However, this is only a part of the picture. The review of intra-group financing would be incomplete without analysing ways to re-allocate funds within an enterprise group. This re-allocation typically takes the form of a single loan transaction or of a series of transactions within a centralised cash management or cash pooling system. Both forms are prevalent in intra-group financing, as exemplified by the cases of Lehman Brothers, Nortel Networks and Oi Brazil.

The purpose of this chapter to discuss intra-group loans – a common way to re-allocate money within an enterprise group. UNCITRAL notes that "[g]roup financing might involve intra-group lending between the parent and other group members, involving loans both from and to the parent and the granting of cross-guarantees."[1] In large groups, like the Lehman Brothers group, intra-group lending is often arranged through an "internal bank", managing the allocation of liquidity across the group. If we imagine a group as a human body, intra-group loans can be compared to blood that circulates throughout the body, supporting the variety of its organs. When one group member is in need of liquidity, other group members have a strong incentive to provide such liquidity.[2] Continuing with the human body analogy, this financing is comparable to a targeted transfer of resources from one organ to another to preserve its functions and possibly save the entire body. Yet, a different scenario of withdrawing funding and using "selective" insolvency is equally possible, where one group member is placed into insolvency to avoid contagion from spreading across the whole group enterprise. The "selective" insolvency strategy may result in the removal of

---

▪ This chapter builds upon the following previously published work by the author:
– I. Kokorin, Intra-Group Financial Support in a Crisis: Between Rescue and Abuse, Norton Journal of Banking Law and Practice, Vol. 29, 2020, pp. 378-420.

1 UNCITRAL Legislative Guide, Part three, Ch. I, para. 10.

2 R. Squire, Limits to Group Structures and Asset Partitioning in Insolvency: Suppressing Value and Selective Perforation by Means of Guarantees in The 800-Pound Gorilla. Limits to Group Structures and Asset Partitioning in Insolvency, NACIIL 2018 report, Eleven International Publishing, 2019, p. 1.

assets (i.e. assets tripping) from a group entity placed in insolvency for the benefit of its affiliates and ultimately, shareholders.[3] These value extraction patterns can be challenged using transaction avoidance rules, touched upon in Chapter 8.

This chapter focuses on a situation where the value is infused rather than taken out of a group company. It proceeds as follows. Section 7.2. mentions some of the reasons why enterprise groups engage in intra-group loans and centralised cash management. Section 7.3. examines the specificity of "insider" creditors, as the divide between internal and external creditors often underlies their different treatment in insolvency. The different treatment primarily manifests in subordination of intra-group (shareholder) loans in insolvency (section 7.4).

The treatment of shareholder loans and, more generally, of intra-group claims is a contentious topic, on which positions vary considerably among jurisdictions and among scholars. In countries like Germany, Austria, Sweden, Portugal, Italy, Spain, Brazil, Slovenia, Poland and Russia,[4] claims from shareholder loans might be subject to statutory subordination rules that re-prioritise or downgrade insider claims in the creditor ranking. In other countries, such as the UK and the Netherlands, no general doctrine of subordination is developed. In the USA, claims of insiders could be subordinated under the doctrine of equitable subordination or recharacterized as equity contributions.

There are different opinions on whether claims of shareholders should rank *pari passu* with those of external creditors or whether they should be placed in a lower rank or treated as equity contributions. The complexity arises from the dual role of a party that holds an equity stake in the debtor or is otherwise connected to it by way of control or corporate ties, while also acting as a lender ("double hat" problem). The question is whether the disparities in the nature, incentives, and risks of internal and external creditors justify different (unequal) treatment of creditors in insolvency. No signs

3 See Final Report of Examiner Richard J. Davis, 15 March 2016, *In re Caesars Entertainment Operating Company Inc.*, Case No. 15-01145 (ABG) (Bankr. N.D. Ill.). The examiner concluded that in the period preceding the debtor's bankruptcy, as a result of a number of transactions, assets were removed from the debtor to its own detriment and to the detriment of its creditors. The damage was estimated to range from USD 3.6 to USD 5.1 billion. The examiner pointed out that "in those transactions no one was focused on CEOC's [debtor's] interest alone as opposed to how transactions impacted Caesars as a whole." See C. Gerner-Beuerle, M. Schillig, Comparative Company Law, OUP, 2019, p. 826, noting that the withdrawal of the company's assets may take the form of loans advanced by the debtor companies to the parent or other group companies.

4 For analysis of the subordination doctrine in insolvency law, see A. Shaydullin, Subordination of shareholder claims in insolvency law, PhD dissertation, 2022 (in Russian) <https://izak.ru/upload/iblock/151/SHaydullin-A.I._Kandidatskaya_dissertatsiya_final_pdf.pdf> (accessed 15 July 2023).

of consensus seem to appear on this issue, neither in academic literature nor in law. This chapter summarises arguments in favour and against the subordination of insider (intra-group) loans and highlights the most serious critique of such subordination – the problem of underinvestment (section 7.5.). Section 7.6. concludes.

7.2 Intra-group Loans and Centralised Cash Management

There are various reasons why enterprise groups utilise intra-group loans and centralised cash management. An intra-group loan offers a relatively easy and quick way to put the funds available within the group to the best use. It provides flexibility, convenience, and confidentiality compared to equity finance, which often requires complying with various formalities.

Within a corporate group, one group member may be able to secure better credit terms due to its credit history, or the level of assets and liabilities. This is why the borrower or issuer of corporate bonds is frequently established as a special purpose financing company, acting for the benefit of other group companies or the entire group. For instance, an SPV arrangement was used by the Parmalat group, a dairy and food enterprise, whose failure produced one of the most important cases on the interpretation of the EIR 2000.[5] Parmalat established the Irish subsidiary Eurofood IFSC Ltd (Eurofood), with the main objective of providing financing facilities to other entities in the group. Its primary purpose was to serve the interests of the group by engaging in the issuance of bonds, which were guaranteed by the Italian holding company Parmalat SpA.[6] Similar financial arrangements were embraced by Lehman Brothers and Oi Brazil. In the Oi group, the operations of the Dutch-incorporated SPVs were limited to issuing notes and on-lending the received funds to other group entities.[7] The relevant notes documentation describes the Dutch companies' conduit role and their full dependence on the performance of the group:

> [Coop, a Dutch SPV] has no operations other than the issuing and making payments on the Notes […] and using the proceeds therefrom [to effectuate] lending the net proceeds of the Notes […] to Oi and subsidiaries of Oi. Accordingly, the ability of [Coop] to pay principal, interest and other amounts due on the Notes and other indebtedness will depend upon the financial condition and results of operations of Oi and its subsidiaries that are creditors of [Coop].[8]

5 Case C-341/04, *Eurofood IFSC Ltd*, 2 May 2006.

6 These financial arrangements have been described in the Opinion of Advocate General Jacobs, delivered on 27 September 2005 in *Eurofood IFSC Ltd*, Case C-341/04, ECLI:EU:C:2005:579.

7 See *In re Oi Brasil Holdings Coöperatief U.A.*, 578 B.R. 169 (Bankr. S.D.N.Y. 2017).

8 Ibid.

One should also keep in mind tax considerations, which often play a large role in determining the way intra-group transactions are structured.[9] For all these reasons, it may be cheaper for a corporate group to use an SPV to attract financing, irrespective of whether this entity will use the funds on its own or transfer them through a chain of other group members.

Centralised cash management or cash pooling facilitates economic and operational efficiency and contributes to increases in profitability. Cash pooling can be divided into "notional pooling" ("virtual cash pooling") and "physical pooling" ("cash sweeping" or "cash balancing"). In the former, no physical transfer of funds takes place as it involves the purely arithmetic consolidation of balances from different accounts. In the latter, balances of various accounts are physically consolidated into one balance in a designated account, a so-called master account.

Cash pooling is popular among corporate groups as it allows a parent company or a financing SPV to control intra-group cash balances of group companies and transfer liquidity from a group entity with a surplus to another group entity with a shortage, without having to attract funds from outside the group. The latter option may be more costly, considering the financial position and availability of unencumbered assets of the entity seeking financing. However, centralisation of funds creates its own problems, particularly when a company holding subsidiaries' cash in a master account becomes insolvent, as it happened with LBHI (for an illustration of Lehman Brothers' cash management system, see figure 1).

Finch and Milman point out that the "arrangements that best meet the needs of healthy, trading companies […] are not those that necessarily produce the smoothest-operating insolvency regimes."[10] This is certainly true for centralised cash management. This group-level liquidity-allocation tool is special (e.g. participating group entities may agree on joint and several liability for deficits of the top account, potentially affecting the position of creditors), presents notable challenges for group restructurings (e.g. access to funds in a master account might be cut off if the company holding a mater account goes bankrupt), and may require tailored solutions to preserve the continued operation of a cash pool (e.g. first-day orders in US bankruptcy cases on cash management). Yet, from a legal standpoint, money transfers between participants of a physical cash pool can be treated

9 On the use of tax havens by multinational enterprises, see P. Muchlinski, Multinational Enterprises and the Law, 3rd edn, OUP, 2021. Tax law aspects of intra-group financing fall outside the scope of this book.

10 V. Finch and D. Milman, Corporate Insolvency Law: Perspectives and Principles, 3rd edn, CUP, 2017, p. 55.

as up-, cross- or downstream loans.[11] This is the reason why the issues addressed below, including subordination, are equally relevant for transfers in a cash management system.[12]

7.3 Internal v. External Creditor Divide

7.3.1 Information asymmetry

Despite the proclaimed equal treatment or equality of creditors, the reality is more complicated. To paraphrase the famous passage of George Orwell, all creditors are equal, but some creditors are more equal than others.[13] In many countries, insolvency law provides special treatment of transactions involving related parties, such as directors, shareholders, and their affiliates, sometimes referred to as "insiders". Related parties typically enjoy reduced protection against transaction avoidance.[14] This materialises in the extension of suspect periods,[15] acceptance of a certain mental element (e.g. knowledge or intention to give preference or to defraud),[16] or a rebuttable

11 J. Jansen (ed), International Cash Pooling: Cross-border Cash Management Systems and Intra-group Financing, Sellier. European law publishers, 2011, p. 6, emphasising that the "purpose of a cash management system is to grant financial assistance between companies within a corporation on a constant basis." P. Mäntysaari, The Law of Corporate Finance: General Principles and EU Law. Volume III: Funding, Exit, Takeovers, Springer, 2010, p. 72, noting that cash concentration creates loans and debts between participating companies. See also W.A.K. Rank, Van saldocompensatie naar saldoconcentratie? MvV, nummer 11, 2018, p. 333, stating that from a legal standpoint, surplus transfers from group companies to the holding or financing company can be regarded as cash loans.

12 For a country-by-country overview of national law approaches to cash pooling and the implications of insolvency for parties involved in it, see M. Willems (ed), Cash Pooling and Insolvency: A Practical Global Handbook, Globe Business Publishing, 2012.

13 G. Orwell, Animal Farm, 1984. The original quote reads as follows: "All animals are equal. But some animals are more equal than others". This quote was of course made in a very different setting and with a different message.

14 In many cases, related parties include members of the same group of companies. For an overview, see Clash of Principles: Equal Treatment of Creditors vs. Protection of Trust in European Transaction Avoidance Laws, CERIL Report 2017/1, 26 September 2017; G. McCormack et al., Study on a new approach to business failure and insolvency, 2016, pp. 142-143.

15 E.g. in the UK, the suspect period for preference transactions is two years for connected persons, compared to the otherwise applicable six-month period (see Insolvency Act 1986, section 240). In the USA, the preference period is extended from the usual 90 days to one year in the case of an insider (11 U.S. Code § 547).

16 Under InsO, § 131(2), a person with a close relationship to the debtor on the date of a [preferential] transaction (§ 138) shall be presumed to have been aware of the disadvantage to creditors in insolvency proceedings. Under Insolvency Act 1986, section 239(6), a company that gave a preference to a person connected with it "is presumed […] to have been influenced in deciding to give it by such a desire as is mentioned in subsection (5)" (desire to create advantage to a counterparty). The knowledge of prejudice in related-party transactions is codified in Article 43(1) Fw.

presumption of the harm caused to creditors.[17] The distinct treatment of related parties finds a way in other rules of insolvency law. For example, US bankruptcy law requires that at least one class of impaired creditors accepts a reorganisation plan, without considering the votes of insiders.[18]

There are several important characteristics that distinguish internal (related) creditors from external (non-related) creditors. One of them has to do with information asymmetry. Internal parties, like shareholders and directors, may have access to internal, non-public information concerning the debtor, including its financial situation and likely prospects of survival. They "tend to have the earliest knowledge of when the debtor is, in fact, in financial difficulty."[19] Conversely, outside the formal insolvency procedure, external creditors usually lack up-to-date and full information about the debtor and have to rely on either publicly available sources or data shared by the debtor.[20] The problem of information asymmetry is even larger in corporate groups for a reason that the financial status of the entire group may need to be assessed to make risk calculations. Outside creditors could be unaware of the true state of affairs of the distressed debtor, given its position within the group.

7.3.2 Power and control

Shareholders can exercise control over the debtor. In the absence of insolvency proceedings, and in some cases even during such proceedings, they retain decision-making rights, including the right to appoint and remove directors. Due to this advantage in knowledge and control, they might be able to "prepare" for insolvency by transferring or pushing debtor's directors to transfer assets or value from the debtor to another group member in the vicinity of insolvency (asset dilution), ultimately to the detriment of the transferring company and its creditors. They may also decide to increase the riskiness of the debtor's business (asset substitution) or its borrowing (debt

17 See e.g. Spanish Insolvency Act (*Ley Concursal*), Article 228(1).

18 11 U.S. Code § 1129(a)(10).

19 UNCITRAL Legislative Guide, Part two, Ch. II, para. 182. D.A. Skeel and G. Krause-Vilmar, Recharacterization and the Nonhindrance of Creditors, EBOR, Vol. 7, 2006, p. 268, observing that shareholders "see the problems first, and they may conclude that arranging an outside loan would be too time-consuming and uncertain."

20 Information asymmetry may be mitigated (but not fully solved) through the inclusion of information covenants. R. Carrizosa, S. Ryan, Borrower private information covenants and loan contract monitoring, Journal of Accounting and Economics, Vol. 64, 2017, pp. 313-339.

dilution). These are examples of opportunistic behaviour, which should be controlled ex ante and remedied ex post.[21]

Adopting the agency-costs-of-debt language of Jensen and Meckling, a threat of opportunistic actions by shareholders induces lenders to engage in additional monitoring efforts, producing monitoring costs. In return, shareholders incur bonding costs to reassure creditors that no such actions will occur.

7.3.3 Risk appetite and misalignment of incentives

The risk appetite of shareholders is often higher compared to external creditors because in insolvency, shareholders' equity stake is wiped out. Shareholders of an insolvent company are last in line and give way to creditors as new residual claimants. At the same time, the limited liability shield protects shareholders from claims of the debtor's creditors. The combination of these features gives them economic incentives to pressure the debtor's management to pursue high risk-high reward strategies, including projects with negative net present value (NPV), to avoid liquidation, retain their equity, and create upside potential.[22]

The risk-shifting incentives of shareholders and managers can result in the so-called "gamble for resurrection", further contributing to the dilution of value available to outside creditors. This happens in a situation where the life of an economically unviable business – a business whose going concern value is lower than its liquidation value – is artificially prolonged at the risk and expense of outside financiers. We should keep in mind that this behaviour is not necessarily rational or intentional. Shareholders and managers may actually believe that their company is viable – a belief affected by

21 J. Armour, G. Hertig and H. Kanda, Transactions with creditors, in R. Kraakman et al. (eds), The Anatomy of Corporate Law: A Comparative and Functional Approach, 3rd edn, OUP, 2017, pp. 111-112.

22 D. Scarlino, Zone of Insolvency, Directors' Duties and Creditors' Protection in U.S., European Business Law Review, Vol. 29, 2018, p. 7. On misalignment of incentives in insolvency, see H. Eidenmüller, Trading in Times of Crisis: Formal Insolvency Proceedings, Workouts, EBOR, Vol. 7, 2006, pp. 239-258; P. Davies, Directors' Creditor-Regarding Duties in Respect of Trading Decisions Taken in the Vicinity of Insolvency, EBOR, Vol. 7, 2006, p. 306, stating that in the vicinity of insolvency directors may focus solely on the upside, however remote the probability of success is. Empirical evidence of insolvency-related risk shifting is inconclusive. A. Eisdorfer, Empirical Evidence of Risk Shifting in Financially Distressed Firms, The Journal of Finance, Vol. 63, 2008, pp. 609-637, supporting the risk-shifting hypothesis. However, see E. Gilje, Do Firms Engage in Risk-Shifting? Empirical Evidence, The Review of Financial Studies, Vol. 29, 2016, pp. 2925-2954, finding that companies in distress reduce investment risk.

various cognitive biases, including the self-serving bias, positive outcome (or optimism) bias, and the illusion of control.[23]

Unlike shareholders, external creditors may prefer risk-averse behaviour or immediate liquidation of the debtor. The reason for this is that they do not share in the upside of high risk-high reward strategies; they are only entitled to the principal (original amount borrowed) plus interest. However, they are among the most affected parties if the risky or life-extending strategy fails and forces the debtor into insolvency.

7.3.4 Minimum capital requirements and capital maintenance

Companies may be financed through debt or equity. The return on the former usually includes the payment of fixed interest. The return on the latter depends on the success of the company and is distributed in the form of dividends or is translated into an increase of the share value. Unlike the return on debt, the return on equity investment is, in principle, unlimited but can be subject to specific company law rules. These rules provide creditors with a guaranteed equity cushion by means of the minimum capital requirements and capital maintenance.

Over the recent decades, many jurisdictions have either eliminated or significantly reduced the need for private companies to have minimum capital levels. This trend has been instigated by regulatory competition and the positions of standard-setting organisations, such as the World Bank.[24] The abolition of minimum capital requirements has simplified the partition of a single enterprise into a myriad of legal entities. In any event, the efficiency of minimum capital requirements is doubtful, as they do not reflect the riskiness of the business and do not account for the potential size of a debtor and its debts. Capital maintenance rules curb the distribution of corporate assets to shareholders (e.g. via the payment of dividends, redemption or

23 On cognitive biases in vicinity-of-insolvency decision-making, see M-W. Hung, W-H. Tsai, Managerial optimism, CEO retention, and corporate performance: evidence from bankruptcy-filing firms, Journal of Economics and Finance, Vol. 44, 2020, pp. 506-526, analysing data on bankruptcy-filing companies in the USA and concluding that managerial optimism is detrimental to operating performance at filing and survival probability. See also F. Drescher, Insolvency Timing and Managerial Decision-Making, Springer Gabler, 2014, p. 84, noting that "context factors of the insolvency timing decisions are very likely to aggravate the manager's cognitive limitations."

24 M. Becht, C. Mayer and H. Wagner, Where do Firms Incorporate? Deregulation and the Cost of Entry, Journal of Corporate Finance, Vol. 14, 2008, pp. 241-256, concluding that incorporations are primarily driven by minimum capital requirements. V. Saltane, P.G. Serna, Why are minimum capital requirements a concern for entrepreneurs? World Bank Doing Business, 2014, pp. 41-45, arguing that such requirements significantly slow entrepreneurship and fail to serve the purpose of protecting creditors.

repurchase of the company's own shares) in a situation where there are no distributable profits.[25] It is highlighted that capital maintenance is not about avoiding insolvency but about giving effect "to the rule that creditors' claims take priority over those of shareholders" and ensuring that distributions to shareholders do not compromise creditors' interests.[26] In other words, capital maintenance rules impose a negative obligation not to make distributions. They do not translate into any positive obligation of shareholders to make new equity contributions or to abstain from intra-group lending.

To conclude, the disparities in the nature, risk appetite and incentives between external and internal creditors are worth keeping in mind. They could be relied on to justify special treatment, consistent with the idea of formal (as opposed to universal) equality, pursuant to which different situations should not be treated in the same way. One may even argue that since shareholders differ from outside creditors, it is fair to treat them differently. However, this simple conclusion does not solve the problem or provide an answer to the question of whether financial support provided by one group member to another should be subordinated in insolvency. For now, it suffices to stress that the distinct traits of internal creditors underlie the subordination debate.

7.4 Subordination of Shareholder Loans: National Perspectives

7.4.1 Contractual v. statutory subordination

The effect of subordination can be achieved by way of a contract – contractual subordination. Inter-creditor agreements establishing the ranking of creditors are common in syndicated loan transactions.[27] It is also common for a parent company to agree to subordinate its loan to a subsidiary in favour of an outside lender, such as a bank. Such subordination can be a pre-condition to secure external financing, as it provides an outside financier with additional protection in case the debtor cannot overcome financial difficulties and goes insolvent. This protection comes from the fact that the outside financier gets paid in priority to and without competition from the

25 See Companies Act 2006, section 830(2), according to which "company's profits available for distribution are its accumulated, realised profits […] less its accumulated, realised losses." See also Article 56 of the Directive (EU) 2017/1132 of the European Parliament and of the Council of 14 June 2017 relating to certain aspects of company law.

26 A. Cahn and D.C. Donald, Comparative Company Law: Text and Cases on the Laws Governing Corporations in Germany, the UK and the USA, 2nd edn, CUP, 2018, p. 257.

27 L. Gullifer and J. Payne, Corporate Finance Law: Principles and Policy, 3rd edn, Hart Publishing, 2020, p. 265.

parent company, whose claim is contractually subordinated.[28] In the context of group financing, subordination can also attach to recourse claims.[29] The main question is whether contractual subordination remains effective in the event of the borrower's insolvency, considering that the ranking of creditors' claims is prescribed by mandatory rules of insolvency law. The default rule of insolvency distribution is that creditors are to be treated equally. This is why there may be doubts about the creditors' ability to opt out from equal treatment by agreeing on subordination.

Contractual subordination is generally allowed and effective in insolvency proceedings in the three jurisdictions discussed in this book. Burrows emphasises that the *pari passu* principle "prevents a creditor from bargaining for an advantage on the distribution of an insolvent's assets, which is not the case with a subordination agreement of this kind [subordination to all other creditors]."[30] He observes that prohibiting these subordination agreements would have a prejudicial effect on companies that depend on the infusion of funds from the parent and sister companies that are prepared to accept subordination.[31]

The validity and effectiveness of subordination agreements are recognised and upheld by courts in the UK,[32] the USA[33] and the Netherlands.[34] In this respect, Gullifer notes that "judicial confirmation of the validity of

28 *Lehman Brothers International (Europe) (In Administration), Re* [2017] UKSC 38, [2018] A.C. 465, [2017] 5 WLUK 397, addressing the issue of contractual subordination as applied to loans extended by LBIE's immediate holding company and noting that "the perception of the reasonable reader would be that the holders of the subordinated debt were to be at the end of the queue – and, in the event of an Insolvency, at the bottom of the waterfall."

29 See LMA Multicurrency Term and Revolving Facilities Agreement, sec. 18.7 (Deferral of Guarantors' Rights).

30 A. Burrows, English Private Law, 3rd edn, OUP, 2013, para. 19-130.

31 Ibid. See also P. Wood, Project Finance, Securitisations, Subordinated Debt, 2nd edn, Sweet & Maxwell, 2007, para. 11-025, noting that "[n]o policy of the insolvency laws is offended if one creditor voluntarily agrees to postpone himself to the others, but only if he seeks to put himself ahead of other unsecured creditors."

32 *Re Maxwell Communications Corp* [1993] 1 W.L.R. 1402, holding that there were no principles of insolvency law or public policy that precluded a contract between a company and creditor whereby, if the company was insolvent, the debt was to be subordinated in the winding up to the payment of debt owed to other unsecured creditors. See also *Re SSSL Realisations* [2004] EWHC 1760 (Ch), dealing with subordination of intercompany debt.

33 11 U.S. Code § 510(a), providing that a contractual subordination agreement is enforceable "to the same extent that such agreement is enforceable under applicable nonbankruptcy law." This rule codifies pre-Bankruptcy Code case law. *In re Credit Industrial Corp.*, 366 F.2d 402 (2d Cir. 1966). The scope and enforceability of subordination agreements are determined by state law. *Wilmington Trust Co. v. Tribune Co.*, 2014 U.S. Dist. LEXIS 82782 (D. Del. June 18, 2014).

34 Dutch Civil Code, Article 3:277(2). Rb. 's-Gravenhage 28 October 2009, *JOR* 2010/317, *RI* 2010/21 (*Van der Eng c.s./SNSPF, Andalucia Projects*). N.B. Pannevis, Achtergestelde vorderingen (Onderneming en recht nr. 114) (diss. Nijmegen), Deventer: Wolters Kluwer 2019.

subordination agreements is very much to be welcomed,"[35] given their predominance in corporate finance. Contractual subordination arises from the principle of freedom of contract and does not negatively impact the interests of creditors. It does not create an unfair advantage; rather, creditors simply agree on how conflicts between their claims should be addressed in the distribution of the debtor's assets. Nevertheless, there may be concerns with a subordination agreement if the lender (parent company) that agreed to subordinate its claim becomes insolvent. In such a scenario, the agreement could potentially harm its creditors. The subordination agreement will be subject to scrutiny under transaction avoidance rules (e.g. as a transaction at an undervalue), and the benefits afforded to the subordinated lender (e.g. higher interest rates, indicating a higher return for increased risk) are likely to be factors influencing the court's analysis. Disputes could also concern the interpretation of subordination clauses, the ranking of subordinated creditors between themselves, and in relation to other creditors.

To the extent that contractual subordination is based on freedom of contract and usually does not impinge on the equal treatment of creditors or their legitimate expectations, it will not be further discussed in this book. We will focus on statutory subordination. Unlike contractual subordination, statutory subordination is not based on a contract. It is prescribed by law and typically applies to claims of insiders, including shareholders and group affiliates. The following sections explore the national law approaches to statutory subordination.

7.4.2 The UK: subordination for claims of shareholders *qua* shareholders

English law treats claims arising from intra-group financial arrangements *pari passu* with other unsecured claims. In the 1933 case *Matthew Ellis & Co. Ltd.*,[36] the debtor that was in financial difficulty obtained a loan from its chairman and controlling shareholder, Mr. Arthur Tipper. The loan was made to ensure the operational continuity of the debtor and was secured by the floating charge over the debtor's assets. It was agreed that a part of this money was to cover the past debt owed to the principal supplier of goods, of which Mr. Arthur Tipper was a partner. This payment in satisfaction of the past indebtedness was a precondition for the future supplies and the only way to keep the debtor's business going.

The liquidator contested the validity of the security, arguing that the money did not come to the debtor free from obligation and that the debtor acted merely as a conduit pipe. The court refused the liquidator's application and

35 R. Goode and L. Gullifer, Goode and Gullifer on Legal Problems of Credit and Security, 6th edn, Sweet & Maxwell, 2017, para. 5-61.

36 *In re Matthew Ellis Ltd* [1933] Ch. 458.

found that the debtor "did secure a valuable advantage in the continuation of the supply of goods […]" and that "the transaction must be considered as a whole and not split up."[37] The fact that the loan and security involved an insider had no effect on the court's reasoning.

Another relevant case in which the claim of a shareholder was at issue is *Soden v. British & Commonwealth Holdings Plc*.[38] In 1988, British & Commonwealth Holdings Plc (B&C) acquired the entire share capital of Atlantic Computers (Atlantic). The acquisition proved to be disastrous. Atlantic went into administration, as did B&C. B&C brought proceedings against Atlantic for damages for negligent misrepresentations made by Atlantic to induce B&C to buy its shares. The question was whether this claim should be subordinated under section 74(2)(f) of the Insolvency Act 1986. According to this section:

> a sum due to any member of the company (in his character of a member) by way of dividends, profits or otherwise is not deemed to be a debt of the company, payable to that member in a case of competition between himself and any other creditor not a member of the company […].

The administrators of Atlantic submitted that "the basic principle applicable was that "members come last", implying that the members of a company (shareholders) should not receive any payment until outside creditors are paid in full. They considered it a "manifest absurdity" if B&C, as a shareholder in its wholly owned subsidiary, was allowed to claim as damages the sums calculated with reference to the price of shares based on the misrepresentation related to their acquisition. The House of Lords did not agree with this position and declined to subordinate the shareholder's claim.

The court made a distinction between two types of shareholder claims: (i) sums due to a member "in his character of a member", which were interpreted as sums falling due under or by virtue of the "statutory contract" between a shareholder and the company and the members inter se – a memorandum and articles of association, and (ii) sums due to a member "otherwise than in his character as a member". Subordination, in this case, applied solely to rights and liabilities created by the constitutional documents of a company or those conferred and imposed on shareholders by the Companies Act. The court did not accept the principle that "members [always] come last", holding that "a member having a cause of action independent of the statutory contract is in no worse a position than any other creditor."[39] Instead, the principle dictates that the rights of shareholders *qua*

37 Ibid.

38 *Soden and Another v. British & Commonwealth Holdings Plc. (In Administration)* [1997] 4 All ER 353.

39 Ibid.

shareholders come last, reflecting the trade-off for limited liability.[40] Since the cause of action in the present case did not stem from corporate membership but rather from a misrepresentation made by the debtor during the purchase of existing shares from a third party, the court did not impose subordination.

Therefore, a narrow interpretation of the "character of a member" was adopted. If a shareholder holds a claim in his capacity of a creditor (e.g. a claim for loan repayment or a subrogation claim), such a claim will not be subordinated. As a result, claims of insiders under intra-group financial transactions commonly rank *pari passu* with unsecured creditors. This means that in insolvency, such claims could be set off against an obligation of contribution.[41]

English law has not developed a general doctrine of equitable subordination.[42] This is not to say that there has been no critique of the current approach to shareholder loans. The famous Report of the Review Committee on Insolvency Law and Practice, also known as the Cork Report, recognised the issue:

> The strength of the case of those who seek a change in the law – and radical at that – can be seen if a simple and perhaps extreme example is taken. A wholly-owned subsidiary company is under-capitalised. It relies virtually wholly on moneys lent by the parent. Its affairs are conducted by and in the interest of the parent and they are mismanaged. […] The subsidiary becomes insolvent and goes into liquidation. The parent company declines all liability for its subsidiary's debt to external creditors, and competes with them by submitting a proof in respect of its loan. The result is that, out of the total funds realised by the liquidator for distribution among the creditors, a substantial proportion goes to the parent company. We recognize that a law which permits such an outcome is undoubtedly a defective law.[43]

---

40 For early cases, see *Re Addlestone Linoleum Co* (1887) 37 Ch.D. 191, ruling that the claimant who is induced to acquire his shares by subscription falls within the class of those who are not allowed to compete with general creditors. See also *Houldsworth v. City of Glasgow Bank* (1888) 5 App. Cas. 317, holding that a shareholder could not sue for damages for misrepresentation made by the company on the occasion of the issue (as opposed to the purchase) of its shares unless he first rescinded the contract, and that once the company had gone into liquidation such a rescission was impossible. See P. Wood, Principles of International Insolvency, 2nd edn, Sweet & Maxwell, 2007, para. 11-073.

41 V. Finch, D. Milman, Corporate Insolvency Law: Perspectives and Principles, 3rd edn, CUP, 2017, p. 533.

42 K. van Zwieten, Goode on Principles of Corporate Insolvency Law, 5th edn, Sweet & Maxwell, 2018, para. 8-30, suggesting that this outcome may be explained by the existence of statutory provisions, such as those enabling subordination of claims of creditor-directors found guilty of fraudulent or wrongful trading (sec. 215(4) and 246ZC of the Insolvency Act 1986).

43 Insolvency Law and Practice: Report of the Review Committee, Cmnd 8558, 1982, pp. 435-436.

The Cork Report made several recommendations for reforms, ranging from joint and several liability of group entities, to the subordination of shareholder loans if they can be properly characterised as capital contributions. It proposed distinguishing debts arising from ordinary intra-group trading activities and debts "which in substance represent long term working capital and which arise from finance provided by the parent company."[44] However, no legislation on the subordination of insider claims was adopted in the UK, neither was it in spotlight of recent insolvency law reforms.

7.4.3 The USA: Equitable subordination and debt recharacterization

7.4.3.1 Equitable subordination: undoing wrongdoing

The doctrine of equitable subordination in the USA allows courts to subordinate the claim of one creditor to the claims of other creditors when the former has engaged in inequitable behaviour, resulting in an unjustified advantage or injury to other creditors of the distressed entity. The doctrine is therefore limited to reordering priorities and does not permit the disallowance of claims as such. In other words, it does not deal with the validity or invalidity of claims. Notably, equitable subordination is not restricted in its personal scope and may in principle apply to any creditor involved in some form of misconduct.[45]

The doctrine of equitable subordination finds its origins in the famous 1939 cases of *Taylor v. Standard Gas & Electric*[46] (often referred to as the Deep Rock case) and *Pepper v. Litton*.[47] In *Deep Rock*, the US Supreme Court considered a claim of Standard Gas & Electric Company (Standard), the corporate parent, against its insolvent subsidiary – Deep Rock Oil Corporation (Deep Rock). Standard ran an open account with thousands of transactions between Standard and Deep Rock from 1919 to 1933. Many of these transactions were attacked as fraudulent, and it was asserted that Standard had made Deep Rock its mere agent or instrumentality.

The Supreme Court held that "[f]rom the outset Deep Rock was insufficiently capitalised, was top heavy with debt and was in parlous financial

44 Ibid., para. 1960.

45 See e.g. *Enron Corp. v. Ave. Special Situations Fund II, LP (In re Enron Corp.)*, 333 B.R. 205 (Bankr. S.D.N.Y. 2005); *Developmental Specialists, Inc. v. Hamilton Bank, N.A. (In re Model Imperial, Inc.)*, 250 B.R. 776 (Bankr. S.D.Fl. 2000). Traditionally, equitable subordination was inapplicable to ordinary creditors, as opposed to insiders. For external creditors, inequitable conduct warranting subordination must be "gross and egregious, tantamount to fraud, misrepresentation, overreaching or spoliation, or involving moral turpitude." See *In re Eufaula Indus. Auth.*, 266 B.R. 483, 489 (B.A.P. 10th Cir.2001).

46 *Taylor v. Standard Gas & Elec. Co.*, 306 U.S. 307 (1939).

47 *Pepper v. Litton*, 308 U.S. 295 (1939).

condition. Standard so managed its affairs as always to have a stranglehold upon it."[48] Due to the findings of abuses by the parent company and inadequate capitalisation of the subsidiary, the Supreme Court ruled that the claim of the parent against its subsidiary should be allowed to participate in the reorganisation plan of the subsidiary only in subordination to the preferred stock of the subsidiary.[49]

Since 1978, the doctrine of equitable subordination has been codified in § 510(c) of the US Bankruptcy Code, which states that:

> […] the court may:
>
> (1) under principles of equitable subordination, subordinate for purposes of distribution all or part of an allowed claim to all or part of another allowed claim or all or part of an allowed interest to all or part of another allowed interest; or
> (2) order that any lien securing such a subordinated claim be transferred to the estate.[50]

The "principles of equitable subordination" are not defined in the US Bankruptcy Code. As follows from the Congressional records, the development of these principles was intentionally left to courts.[51] This makes equitable subordination "a potentially vague standard".[52]

The case law has formulated a number of requirements to guide courts in their application of the doctrine. In the widely quoted pre-reform case of *In re Mobile Steel Corp.*,[53] a three-prong test for equitable subordination was proposed: (i) the claimant must have engaged in some type of inequitable

---

48 *Taylor v. Standard Gas & Elec. Co.*, 306 U.S. 307, 315 (1939).

49 *Pepper v. Litton*, 308 U.S. 295, 307 (1939), confirming the equitable power of courts "to sift the circumstances surrounding any claim to see that injustice or unfairness is not done in administration of the bankrupt estate."

50 11 U.S. Code § 510(c).

51 124 Cong.Rec.H 11095, H 11113 (Sept. 28, 1978), stating: "It is intended that the term "principles of equitable subordination" follow existing case law and leave to the courts development of this principle. To date, under existing law, a claim is generally subordinated only if holder of such claim is guilty of inequitable conduct." Interestingly, the initial bill introduced in the House of Representatives (H.R. 31, 94th Cong. (1976)) and the Senate ((H.R. 31, 94th Cong. (1976)) prescribed a blanket subordination of all claims of insiders and their affiliates. The Congress rejected this statutory language.

52 A.J. Levitin, Business Bankruptcy: Financial Restructuring and Modern Commercial Markets, Wolters Kluwer, 2016, p. 957, adding that "as a standard, it is difficult to say exactly what will trigger or not trigger equitable subordination." J. Kilborn, National Report for the United States, in D. Faber et al. (eds), Ranking and Priority of Creditors, OUP, 2016, para. 19.40, noting that the equitable nature "makes application of this doctrine inherently difficult to predict."

53 *Benjamin v. Diamond (In re Mobile Steel Co.)*, 563 F.2d 692 (5th Cir. 1977). The proposed formula was implicitly endorsed by the US Supreme Court in *United States v. Noland*, 517 U.S. 535 (1996).

conduct; (ii) this misconduct must have resulted in injury to the creditors of the bankrupt or conferred an unfair advantage on the claimant; and (iii) equitable subordination of the claim must not be inconsistent with the provisions of the US Bankruptcy Code. While the second (injury or unfair advantage) and the third (consistency with the law) prongs of the test are relatively unambiguous, the first element, namely "inequitable conduct" or as one court has referred to it, conduct "that shocks one's good conscience",[54] is not precise.

Courts acknowledge that equitable subordination is an extraordinary remedy, and not a penalty, that needs to be employed sparingly.[55] When it comes to claims of insiders, the doctrine has been used in situations involving: (i) fraud, illegality, or breach of fiduciary duty; (ii) undercapitalization; and (iii) control or use of the debtor as an alter ego for the benefit of a claimant.[56] Also, courts apply higher levels of scrutiny when dealing with the claims of insiders[57] and are willing to shift the burden to such insiders to prove both the good faith of the transaction and its inherent fairness.[58]

In the case of *In re Herby's Foods Inc.*,[59] the court ordered the subordination of shareholder loans based on the premise that the debtor's capital was insufficient to support its operations and that the debtor was already insolvent at the time of acquisition by the shareholder. However, the court noted that undercapitalisation alone was not sufficient to justify equitable subordination. Thus, additional grounds or factors for subordination were necessary. Among other factors, the court pointed out that: (i) the insiders never injected any equity capital into Herby's, "electing instead to advance

54 *In re 80 Nassau Associates*, 169 B.R. 832, 837 (Bankr. S.D.N.Y. 1994).

55 See e.g. *In re Alternate Fuels, Inc.*, 789 F.3d 1139 (10th Cir. 2015); *In re Vetter Assets Service, LLC*, 609 B.R. 279 (Bankr. W.D. Okla. 2019); *In re Lifschultz Fast Freight*, 132 F.3d 339, 347 (7th Cir.1997), holding that "[w]rongful or unpredictable subordination spawns legal uncertainty of a particular type: the risk that a court may refuse to honor an otherwise binding agreement on amorphous grounds of equity."

56 *In re Fabricators, Inc.*, 926 F.2d 1458, 1467 (5th Cir.1991); *In re Monahan Ford Corp. of Flushing*, 340 B.R. 1, 44 (Bankr. E.D.N.Y. 2006).

57 Collier on Bankruptcy, 16th edn, 2022, Vol. 4, ¶ 510.05, explaining that a high-level scrutiny is explained by the fact that "insiders have somewhat enhanced opportunities to adjust their position in such a way that other creditors are prejudiced, and therefore, a close inquiry as to whether their claims ought to be subordinated is justified."

58 *Benjamin v. Diamond (In re Mobile Steel Co.)*, 563 F.2d 692 (5th Cir. 1977); *In re Virginia Broadband, LLC.*, 521 B.R. 539 (Bankr. W.D. Va. 2014); *In re Mid-Town Produce Terminal, Inc.*, 599 F.2d 389, 392 (10th Cir.1979), noting that "[b]ecause there is incentive and opportunity to take advantage, dominant shareholders and other insiders' loans in a bankruptcy situation are subject to special scrutiny." However, *In re LightSquared Inc.*, 511 B.R. 253, 348 (Bankr. S.D.N.Y. 2014), stating that "courts in this District have held that there is no different or heightened standard by which to judge a non-insider's conduct, though there may be fewer traditional grounds available because neither undercapitalization nor breach of fiduciary duty applies to the conduct of a non-insider."

59 *In re Herby's Foods, Inc.*, 2 F.3d 128 (5th Cir. 1993).

funds through tardily perfected secured loans made at times when no bona fide third-party lender would have done so"; (ii) the parent's loan was not initially reflected on the debtor's books, and when it was finally booked, it was listed as an unsecured loan; (iii) the security interests were perfected only after the debtor stopped making interest payments; (iv) the aggregate size of the debtor's unsecured debt to its trade creditors increased fivefold – an outcome, at least partially attributed to the shareholder's misrepresentations, which encouraged outside creditors to increase their credit exposure to Herby's. The court considered these factors together as indicative of inequitable behaviour, justifying, in the court's view, subordination of the shareholder loans.

Fact-sensitive analysis is a characteristic feature of cases involving equitable subordination. For example, in contrast to the previous case, in *In re SI Restructuring, Inc.*,[60] the court did not subordinate the loan granted by shareholders, even though the loan was secured. It concluded that the proceeds of the loan were used to pay unsecured creditors and to keep the company in operation. According to the court, this meant that unsecured creditors, as a class, were not harmed by the granting of security. Another argument made was that the creditors were harmed due to the value of the debtor deteriorating as a result of "prolonging an insolvent corporation's life through bad debt", as a result of "deepening insolvency". The court declined to follow this theory.[61]

Another case addressing secured loans of shareholders is *In re Phase I Molecular Toxicology Inc*.[62] In this case, the court refused to subordinate the loans, despite them being made at a time when the thinly capitalised debtor was unable to obtain needed financing from any outside source. It reasoned that the purpose of these loans was to cover the debtor's operating expenses until the closing of the anticipated sale of its subsidiary, which was expected to generate significant funds. Additionally, the court considered that the provision of collateral to secure the shareholder loans was not unreasonable and did not rise to the level of inequitable conduct.

In summary, the doctrine of equitable subordination has been developed as a remedy to address inequitable conduct and restore justice or balance among creditors. While not being limited to insiders, the degree of culpable behaviour and the burden of proof required in cases involving internal

60 *In re SI Restructuring Inc.*, 532 F.3d 355 (5th Cir. 2008).

61 Under the theory of "deepening insolvency", directors may be held liable for prolonging the debtor company's life to the detriment of creditors. This theory remains controversial and has been rejected by several courts. For example, the Delaware Supreme Court did not recognise deepening insolvency as an independent cause of action. See *Trenwick Am. Litig. Trust v. Billet (Trenwick)*, 931 A.2d 438 (Del. 2007).

62 *In re Phase I Molecular Toxicology, Inc.*, 287 B.R. 571 (Bankr. D.N.M. 2002).

and external creditors differ.[63] Yet the mere fact of an insider relationship is insufficient to warrant subordination.[64] As pointed out in one case, insiders are often "the persons most interested in restoring and reviving the debtor, and such bona fide efforts should be viewed with approval."[65] The prevailing fact-based analysis demands more than a simple crisis or undercapitalisation of the debtor at the time of financing. Thus, a showing of deception about the debtor's financial condition or some other misconduct is necessary.

7.4.3.2 Debt recharacterization: discovering parties' intentions

Alongside the equitable subordination remedy, US courts acknowledge their power to re-classify debt (11 U.S. Code, §101(12)) as an equity interest (11 U.S. Code, §101(16)) and to treat a loan as a capital contribution. There is no specific provision in the US Bankruptcy Code that allows claim recharacterization. Some courts derive the right to recharacterize a debt claim as equity from general equitable powers.[66] Other courts base their recharacterization mandate on the statutory authority to allow and disallow claims under state law.[67] In practice, the economic effects of debt recharacterization may be similar to those of subordination of a claim pursuant to equitable subordination. In both cases, the claim is placed behind the claims of other creditors, making its satisfaction unlikely.[68] Nevertheless, it is accepted that

---

63 C.J. Tabb, Law of Bankruptcy, 4th edn, West Academic Publishing, 2016, p. 714, observing that "[i]nequitable conduct sufficient to support a finding of equitable subordination is much easier to establish in the case of a creditor who is an *insider* or an *alter ego* of the debtor" and, conversely, "[c]ourts are very reluctant to subordinate the claim of a noninsider creditor."

64 Collier on Bankruptcy, 16th edn, 2022, Vol. 4, ¶ 510.05.

65 *In re Hyperion Enterprises, Inc.*, 158 B.R. 555 (D.R.I. 1993); cited with approval in *In re AutoStyle Plastics, Inc.*, 269 F.3d 726, 745 (6th Cir. 2001), adding that "[i]nsider transactions are more closely scrutinized, not because the insider relationship makes them inherently wrong, but because insiders "usually have greater opportunities for […] inequitable conduct." See also *In re Rego Crescent Corp.*, 23 B.R. 958, 964 (Bankr. E.D.N.Y. 1982), holding that "the penalty for attempting to save the corporation should not be subordination".

66 11 U.S. Code § 105(a), which states that bankruptcy judges have the authority to "issue any order, process or judgment that is necessary or appropriate to carry out the provisions" of the US Bankruptcy Code. See *In re Dornier Aviation, Inc.*, 453 F.3d 225 (4th Cir.2006).

67 11 U.S. Code § 502(b), which permits courts to disallow debt claims that state law classifies as equity. See *In re Lothian Oil*, 650 F.3d 539, 542 (5th Cir.2011), also confirming that "recharacterization extends beyond insiders and is part of the bankruptcy courts' authority to allow and disallow claims under 11 U.S.C. § 502." The court applied Texas law and ruled in favour of recharacterization. For critique of the split between the courts and support of sole reliance on state law, see J.M. Wilton, W.A. McGee, The Past and Future of Debt Recharacterization, The Business Law, Vol. 74, Winter 2018-2019, pp. 91-125.

68 R. Craig, Groups of companies: the parent subsidiary relationship and creditors remedies, PhD thesis, University of Durham, 1999, p. 322.

the two doctrines are distinct, serve different purposes and involve different considerations.

In *In re AutoStyle Plastics*,[69] it was explained that recharacterization determines the existence of debt by focusing on the underlying substance of the disputed transaction, while equitable subordination answers the question of whether a claim should be subordinated due to the creditor's inequitable conduct. If the claim is recharacterized, the equitable subordination analysis does not come into play.[70]

Despite the predominant view that the US Bankruptcy Code authorises courts to recharacterize claims, the circuits have taken different approaches in identifying the legal framework for such recharacterization.[71] Most courts use flexible and multi-factor tests to determine when a debt claim can be recharacterized as equity.

Wheaton identified three separate lines of federal case law addressing recharacterization.[72]

The first line of cases is represented by the two-pronged test, pursuant to which a shareholder loan may be deemed a capital contribution in two circumstances: (i) the debtor was initially undercapitalised; or (ii) no other disinterested lender would have extended loans at the time they were made.[73] This test is not widely applied, as it may discourage an insider from providing a loan to a distressed company, even if the insider is acting in the best interests of the company and its creditors.

The second line of cases includes a few early decisions in which courts refused to apply the doctrine of recharacterization based on the lack of authority to recharacterize loans. In *In re Pacific Express*, the court stated that "[w]here there is a specific provision governing these determinations [§ 510(c), equitable subordination], it is inconsistent with the Bankruptcy Code to allow such determinations to be made under different standards

---

69 *In re AutoStyle Plastics, Inc.*, 269 F.3d 726 (6th Cir. 2001).

70 *United States v. Colorado Invesco, Inc.*, 902 F.Supp. 1339 (D.Colo.1995); *Sinclair v. Barr (In re Mid–Town Produce Terminal, Inc.)*, 599 F.2d 389, 393 (10th Cir.1979), noting that "the usual procedure is to first determine whether the transaction was a contribution to capital rather than a loan."

71 Collier on Bankruptcy, 16th edn, 2022, Vol. 4, ¶ 510.02, noting that "[c]ourts have adopted various multi-factored tests borrowed from nonbankruptcy case law to define the recharacterization inquiry."

72 C. Wheaton, Clearing a Minefield of Insolvency Law: Toward Debt Recharacterization as a Supplement to the Bankruptcy Code, Santa Clara Law Review, Vol. 55, 2015, pp. 769-798.

73 *Estes v. N & D Props., Inc.*, 799 F.2d 726, 733 (11th Cir. 1986).

through the use of a court's equitable powers."[74] It seems that this position is no longer supported or followed.[75]

The third and by far the most prevalent position embraces the multi-factor tests, largely inspired by tax law cases concerning tax benefits of insider loans granted to solvent companies. These tests were never designed to apply to recharacterize loans extended to insolvent companies in the context of intra-group financing.[76] They addressed the tax treatment of interest expense as an important revenue issue. The most commonly cited case in this respect is *Roth Steel Tube Co. v. C.I.R.*, which determined the following catalogue of 11 factors to be used in making the capital contribution vs. loan determination:

(1) the names given to the instruments, if any, evidencing the indebtedness; (2) the presence or absence of a fixed maturity date and schedule of payments; (3) the presence or absence of a fixed rate of interest and interest payments; (4) the source of repayments; (5) the adequacy or inadequacy of capitalization; (6) the identity of interest between the creditor and the stockholder; (7) the security, if any, for the advances; (8) the corporation's ability to obtain financing from outside lending institutions; (9) the extent to which the advances were subordinated to the claims of outside creditors; (10) the extent to which the advances were used to acquire capital assets; and (11) the presence or absence of a sinking fund to provide repayments.[77]

Under this multi-factor test, no single factor is seen as controlling or decisive.[78] Instead, all the factors need to be considered. Notably, the insider status, undercapitalisation and dire financial circumstances surrounding the infusion of cash alone have been regarded as insufficient to cause debt recharacterization.[79]

---

74 *In re Pacific Express, Inc.*, 69 B.R. 112, 115 (9th Cir. BAP 1986); *In re Pinetree Partners, Ltd.*, 87 B.R. 481 (Bankr. N.D.Ohio 1988) (following *In re Pacific Express*).

75 *In re Fitness Holdings Intern.*, 714 F.3d 1141, 1147 (9th Cir. 2013), noting that "[b]ecause we hold that a court may recharacterize an obligation that does not constitute "debt" under state law, we disagree with *In re Pacific Express, Inc.*"

76 *In re Rego Crescent Corp.*, 23 B.R. 958, 962 (Bankr. E.D.N.Y. 1982), commenting on the use of tax law tests that "the legal questions and policy considerations underlying that determination [dividend vs. loan for tax purposes] are so removed from determining whether money advanced should be considered capital contributions or loans for bankruptcy purposes that those cases are in no way relevant to the inquiry before this court."

77 *Roth Steel Tube Co. v. Commissioner of Internal Revenue*, 800 F.2d 625, 630 (6th Cir. 1986). Another often cited case is *Fin Hay Realty Co. v. U.S.*, 398 F.2d 694, 696 (3d Cir. 1968), proposing a list of 16 distinguishing factors. Also, *Estate of Mixon v. United States*, 464 F.2d 394 (5th Cir.1972), adopting a 13-factor test.

78 In cases involving recharacterization, courts typically go over all the factors under the prevailing test. See e.g. *In re Lyondell Chemical Company*, 544 B.R. 75 (Bankr. S.D.N.Y. 2016); *In re Live Primary, LLC*, 626 B.R. 171 (Bankr. S.D.N.Y. 2021).

79 *In re Dornier Aviation, Inc.*, 453 F.3d 225 (4th Cir.2006); *In re SubMicron Systems Corp.*, 432 F.3d 448 (3d Cir. 2006).

The variability of tests and plurality of factors that may dictate the outcome of a case have been criticised as problematic from the standpoint of predictability.[80] Furthermore, courts have acknowledged that recharacterization does not depend on how many of the relevant factors are met; they also assign different weight to these factors. In one case, it was noted that "no mechanical scorecard suffices. And none should, for Kabuki outcomes elude difficult fact patterns."[81] In our view, predictability of Kabuki outcomes can actually be a virtue, especially from the perspective of group (insider) financiers, without any wrongful conduct on their part. The reason is that the totality-of-the-facts-in-each-case test affords courts wide discretion to recharacterize insider debt as equity. This creates legal uncertainty and compels insiders to engage in a box-ticking exercise to comply with formalities typical of debt instruments. After all, carefully documented loans are less likely to be recharacterized, but uncertainty may still remain. For example, in *In re AtlanticRancher*,[82] the court recharacterized an insider loan, despite the fact that the loan was properly documented, used for working capital, and treated as debt on the debtor's books. Yet, when making the decision to recharacterize, the court held that the insider never made any effort to collect the debt or to foreclose on his collateral. It noted that the creditor "recognized that if he attempted to exercise his rights as a secured creditor it would have put the company out of business."[83] According to the court, the creditor's behaviour signalled that the debt was not treated as a loan but rather as an investment.

To conclude, the boundaries of the recharacterization doctrine in the USA are not clear. First, the very legal basis of the doctrine is disputable. While some US courts rely on the equitable powers granted to them under § 105(a) of the US Bankruptcy Code, other courts adhere to the view that the power to recharacterize should be derived from state law. Second, different multi-factor tests are developed to determine whether an insider loan should be treated as an equity contribution. These tests may produce inconsistent and unpredictable results. They could also have a chilling effect on the willingness of insiders to extend financing to a financially distressed

---

80 D.A. Skeel and G. Krause-Vilmar, Recharacterization and the Nonhindrance of Creditors, EBOR, Vol. 7, 2006, p. 278, arguing that there are two intractable problems with the "welter of factors". The first being that many of such factors "are either unhelpful or used in precisely the wrong way". The second problem is that the list of factors "tended to distort court's analysis of what should and should not be honored as a loan." H.A. Goehausen, You Said You Were Going to Do What to My Loan? The Inequitable Doctrine of Recharacterization, DePaul Business and Commercial Law Journal, Vol. 4, 2005, p. 133, noting that the doctrine has spawned "conflicting standards and inconsistent judicial decisions" and pointing out that since the doctrine does not require a showing of bad faith or misconduct on the part of a lender, "it is easier for a trustee or creditor to be successful in a recharacterization action then in a claim for equitable subordination."

81 *In re SubMicron Systems Corp.*, 432 F.3d 448, 456 (3d Cir. 2006).

82 *In re AtlanticRancher*, Inc., 279 B.R. 411 (Bankr. D. Mass. 2002).

83 Ibid., at 437.

group member or to refuse to foreclose on collateral or collect the loan in hopes of rescuing such a group member.[84] Third, the parallel existence of two doctrines – equitable subordination and recharacterization – with some overlapping elements or factors (e.g. undercapitalisation) and similar results is hard to justify. It may lead to confusion and further complicate the position of internal creditors.

7.4.4 The Netherlands: conflicting authorities

The issue of statutory subordination of shareholder loans is not settled in the Netherlands.[85] The Dutch Bankruptcy Act does not contain express rules on shareholder loans, and the case law remains contradictory.

In *Oude Grote Bevelsborg q.q./Louwerier q.q.*,[86] the District Court of Breda ruled in favour of subordinating an intercompany claim. The case concerned a claim of the parent company (Stichting Ambacht) against its subsidiary (Ambacht B.V.). The latter was highly dependent on the support from its parent, which provided staff, equipment and materials. When Stichting Ambacht became insolvent, Ambacht B.V. ended up in bankruptcy. The trustee of the parent company submitted a claim in the bankruptcy proceedings of Ambacht B.V. The trustee of the subsidiary did not dispute the existence of the claim but argued that it should be subordinated and treated as a capital contribution. If subordination was ordered, the ordinary creditors could receive the full payment on their claims. Without subordination, the payouts would drop to 40-45%.

The court considered the method of financing and the relationships between the group entities. It noted that in special circumstances there may be grounds to treat a claim as subordinated, even if there was no contractual basis for it. In answering the question of whether in the present case there was a reason to treat the parent's claim differently from the claim of other creditors, the court considered both the method of financing and the interrelationship between the group entities. The court concluded that the claim of Stichting Ambacht against Ambacht B.V. should be considered an informal provision of capital, subordinated to the claims of other creditors. It took into account the close business integration of the two companies. Both

84 For a similar view, see S. Mba, New Financing for Distressed Businesses in the Context of Business Restructuring Law, Springer, 2019, p. 52. Mba refers to the situation around recharacterization tests as a "doctrinal bedlam". J.M. Wilton, W.A. McGee, The Past and Future of Debt Recharacterization, The Business Law, Vol. 74, Winter 2018-2019, p. 106, noting that the use of various tests leads to unpredictable results "that discourage out-of-court workouts and reorganization of insolvent businesses."

85 J. Barneveld, F. Corpeleijn, Financiering met risicomijdend vermogen? Over de aandeelhouderslening in faillissement, TvI 2014/39.

86 Rb. Breda 7 July 2010, *JOR* 2010/293 (*Oude Grote Bevelsborg q.q./Louwerier q.q.*).

companies performed similar activities, used the same staff, and even completed work of each other, only deciding afterwards whether to assign such work to Stichting Ambacht or Ambacht B.V. The subsidiary's continued existence depended on its parent company. This close connection between the two companies was also apparent from the fact that the insolvency of the parent caused the insolvency of its subsidiary. Given these circumstances, the court pointed out that it would be "contrary to reasonableness and fairness for a controlling shareholder that has established the company, had absolute control over the company and has maintained it through the current-account financing, to share in the proceeds of the insolvency estate in the same way as unsecured creditors."[87]

This line of reasoning was not followed in *P&O Partner/Wind Holding*.[88] The debtor company was a developer and manufacturer of offshore wind turbines. On 30 June 2009, the debtor was declared bankrupt. Wind Holding B.V. (Wind) held a 90% stake in the debtor company. Wind itself became insolvent. Pursuant to the loan facility agreement dated 1 October 2008, Wind transferred more than EUR 10 million to the debtor over the period from 31 December 2008 to 8 May 2009. This was the claim submitted by Wind in the insolvency proceedings of the debtor. One of the debtor's creditors, P&O Partner B.V. (P&O), argued that the shareholder loan must be subordinated. The court disagreed.

First, it referred to Article 3:277(1) of the Dutch Civil Code, which states that creditors have an equal right to recover their claims from the debtor's assets, except for reasons of priority granted by law. Second, the court acknowledged that a debtor and a creditor may contractually agree on subordination (Article 3:277(2) BW). It did not follow from the loan documentation that such an agreement was reached in the case at hand. P&O submitted that the parties had decided to convert the loan into equity, and in line with the judgment in the above case, the loan should be treated as an informal capital contribution. However, the conversion from debt to equity was not finalised, nor was it proven that the parties always intended

87 Ibid. Also Gerechtshof Amsterdam 5 November 2005, *JOR* 2007/51, m.nt. S.M. Bartman (*Carrier 1*), where the court approved the unequal treatment of the parent company under the restructuring plan (the parent was promised a smaller distribution of 5.6% compared to other unsecured creditors receiving 33%). The court concluded that the plan was the only feasible compromise and that the loan to the wholly owned subsidiary, in the given situation, at least partly had the character of a capital injection. No specific reasoning was given for classifying the loan as "capital replacement", but the first instance court focused on the fact that the loan was provided at a time and under conditions that would not be accepted by any third party. Commenting on *Carrier 1*, Bartman questioned whether, in the absence of a clear legal basis for a distinction between capital-replacing and other loans, the court's motivation would stand in cassation.

88 Gerechtshof Arnhem-Leeuwarden 10 March 2015, *JOR* 2015/160, m.nt. J. Barneveld (*P&O Partner/Wind Holding*).

to convert the loan into equity. Third, the court noted that Wind's loan to the debtor was an intercompany or shareholder loan, which had no special status under Dutch law, in a sense that Dutch law did not prescribe its subordination. It could not be deduced from case law and literature that the prevailing doctrine supported subordination or that subordination was desirable. Fourth, the court accepted that unlawful behaviour of the parent company may result in its liability towards the subsidiaries' creditors under Article 6:162 BW as a tortious act. It is generally accepted that a parent company must take into account the interests of (future) creditors of its subsidiary when financing such a subsidiary. This is relevant where, in the absence of any real prospects of survival, the subsidiary is financed by shareholder loans, which could mislead creditors and create the impression of creditworthiness, while it would have been in the interest of creditors to cease the debtor's activities. Finally, the court mentioned that subordination could possibly be construed on the basis of the principle of reasonableness and fairness.[89] In the given case, however, this principle was not breached.

In summary, the analysis of the limited case law from lower Dutch courts concerning subordination of shareholder loans does not lead to a clear conclusion. The Dutch Bankruptcy Act does not explicitly address this issue, and the Dutch Supreme Court has not yet expressed its position. However, it is clear that there is no automatic subordination of insider claims. If such subordination is available at all, it is reserved for cases involving harmful behaviour by an insider. In this context, subordination might be seen as compensation for improper conduct.[90] An insider may also be deemed to act unlawfully when disregarding the standards of reasonableness and fairness as applied to creditors. This brings the Dutch approach closer to the US doctrine of equitable subordination, as both require some form of inequitable conduct and reject the notion that insider status alone justifies subordination.

Yet one should exercise caution when drawing any parallels. There are several reasons why making a comparison may be difficult or undesirable, including: (i) the inherent ambiguity of the term "inequitable conduct" and the boundaries of "reasonableness and fairness"; (ii) the fact that, unlike the US Bankruptcy Code, the Dutch Bankruptcy Act does not contain any specific rules on subordination; (iii) the lack of internal coherence in the application of the subordination rules and standards. This is explained

89 On reasonableness and fairness as applied to creditors, see F.M.J. Verstijlen, De faillissementscurator, W.E.J. Tjeenk Willink, 1998, p. 73ff; M.J.M. Franken, Verificatie van vorderingen, redelijkheid en billijkheid tussen schuldeisers onderling: een gemiste kans?, in: N.E.D. Faber et al., De bewindvoerder, een octopus, Serie Onderneming en Recht deel 44, Deventer: Kluwer 2008.

90 N.B. Pannevis, Achtergestelde vorderingen (Onderneming en recht nr. 114) (diss. Nijmegen), Deventer: Wolters Kluwer 2019, 2.4.

by the fact-sensitive analysis characterising cases involving intercompany financing and subordination of insider debt. This is in contrast to UK law, which only subordinates shareholder claims closely tied to the shareholder status (e.g. payment of dividends) and does not prescribe subordination of shareholder loans. Comparative analysis shows the divergence of approaches, necessitating taking a closer look at the arguments found in case law and literature in favour and against statutory subordination of insider claims. Some of them are examined below.

7.5 Shareholder Loans: to Subordinate or not to Subordinate?

7.5.1 Facilitation of early insolvency filings

There is no *communis opinio* or widely held view as to whether financing provided by related parties should be subordinated in insolvency, and if so, under which conditions and with what exceptions, if any. The landscape of national responses to these questions is equally divided. This section offers a concise overview and assessment of some arguments in favour and against statutory subordination of insider loans. In this overview, references to German cases and literature will be made because these sources are particularly well-developed and insightful on the given subject, owing to the strictness and pervasiveness of the German subordination rules.

One of the arguments used in support of the rules imposing subordination of shareholder loans is that it facilitates early filings for insolvency, thereby preventing the build-up of non-performing loans and minimising creditor losses. For example, the materials supplementing the Austrian Equity Substitution Act (EKEG) recognised that subordination of loans has the side effect of counteracting the delay in insolvency filings.[91] This is premised on the assumption that before granting a loan, a shareholder will be more cautious in evaluating the chances of a successful restructuring. If the chances are low (and therefore, the return on the subordinated loan is unlikely), the support will not be provided, and the debtor would be more inclined to file for insolvency in a timely manner. Along the same lines, the German Federal Court of Justice (BGH) has held that the recharacterization of shareholder loans is not solely intended to prevent the shareholder from satisfying its claims before or alongside creditors, but it should also rule out the delay in a crisis response and curb any further reduction of remaining

91 Bundesgesetz, mit dem ein Bundesgesetz über Eigenkapital ersetzende Gesellschafterleistungen (Eigenkapitalersatz-Gesetz - EKEG) geschaffen wird sowie mit dem die Konkursordnung, die Ausgleichsordnung, das Unternehmensreorganisationsgesetz und das Übernahmegesetz geändert werden (Gesellschafts- und Insolvenzrechtsänderungsgesetz 2003), <https://www.parlament.gv.at/PAKT/VHG/XXII/I/I_00124/index.shtml> (accessed 15 July 2023).

assets at the expense of creditors.[92] The BGH emphasises the importance of ensuring that a shareholder uses equity support if it enables the debtor to continue trading and thereby creates an impression to outside creditors of a fully capitalised and viable company. If the shareholder recognises that the company is no longer viable, he must either refuse to support such a company and initiate liquidation, or, if he decides to continue providing assistance, he should do so at his own risk.[93]

Nevertheless, the correlation between subordination of shareholder loans and early insolvency filings is not obvious. Meilicke argues that the goal of a timely insolvency filing is more likely to be achieved without subordination. By granting an unsecured loan, a shareholder acquires a stake ("skin in the game") and an incentive to implement successful restructuring. In other words, a shareholder loan aligns the interests of a shareholder with those of external creditors. In contrast, subordination could make the shareholder go all-in, as he has nothing to lose if the insolvency filing is delayed.[94] Verse agrees and points out that if a shareholder bears the risk of non-return of the loan, he has "a strong incentive to avoid excessive risk and to make a careful assessment of the chances of the company's survival before granting the loan."[95] Similarly, Cahn expresses doubts that, in the absence of subordination, shareholders would be inclined to finance inefficient rescue attempts or artificially extend the life of economically unviable businesses.[96] Some authors suggest that the goals of timely insolvency filing and adequate protection of creditors may be better achieved through other legal mechanisms and remedies, including liability for wrongful trading and transaction avoidance.[97]

---

92 BGH, Urteil vom 16. Oktober 1989 - Az. II ZR 307/88.

93 Ibid.

94 W. Meilicke, Das Eigenkapitalersatzrecht - eine deutsche Fehlentwicklung, GmbH-Rundschau, 2007, s. 225-236.

95 D.A. Verse, Shareholder Loans in Corporate Insolvency – A New Approach to an Old Problem, German Law Journal, Vol. 9, 2008, p. 1116.

96 A. Cahn, Equitable Subordination of Shareholder Loans? EBOR, Vol. 7, 2006, p. 300, observing that "given the uncertainties inherent in calculating expected values and the fact that shareholders are not likely to put substantial amount of fresh money at stake if they do not have good reason to expect a successful turnaround, the chances in practice of fostering overinvestment are probably negligible."

97 H. Eidenmüller, Comparative Corporate Insolvency Law, in J.N. Gordon, W-G. Ringe (eds), The Oxford Handbook of Corporate Law and Governance, OUP, 2018, p. 1024; J. Barneveld, Financiering en vermogensonttrekking door aandeelhouders, Serie vanwege het Van der Heijden Instituut, vol. 120, Deventer: Kluwer, 2014, p. 584, arguing that "[r]ather than an unconditional subordination of all shareholder loans that were furnished in a crisis or a general prohibition of shareholder security, inefficient rescue operations should be prevented by the threat of the wrongful act and the fraudulent transfer (in bankruptcy law)."

7.5.2 Responsibility for consequences of financial decisions

Responsibility for financial decisions represents an important doctrinal basis relied upon by courts and scholars to support statutory subordination. The BGH explains that subordination arises from the shareholders' responsibility to finance their company.[98] This responsibility does not impose a positive obligation on them to replenish the lack of capital from their own assets. Yet, the argument goes, it entails that a shareholder cannot choose a less risky form of financial support to the detriment of other creditors. In other words, if the company is in financial distress, shareholders should take *special responsibility* for the consequences of financial decisions. A similar idea was expressed in the materials accompanying the EKEG.

It is accepted that shareholders are in principle free to choose the form of financing – debt or equity (*Grundsatz der Finanzierungsfreiheit*).[99] Debt financing (e.g. shareholder loan) could be preferred as a more flexible financing instrument compared to a capital increase, as it can be used at short notice when necessary to improve the dire liquidity situation and to avoid defaults and cross-defaults. Subordination of shareholder loans may constitute an interference with the freedom to select the means of financing. If insiders maintain this freedom and are not obliged to finance their companies with equity, where does the special responsibility come from? It is argued that it arises from unwritten general obligations of conduct of shareholders (*allgemeine Verhaltenspflichten der Gesellschafter*).[100]

It appears that the concept of "responsibility for consequences of financial decisions" is linked to the power of shareholders to direct the company and decide what to do with it once it has entered a crisis period. If the company is in a crisis, its shareholders should decide whether to liquidate it or to provide the necessary funding. However, it is not apparent why such funding should be extended in the form of equity. Besides, following the amendments to the InsO in 2008,[101] the distinction between loans granted during the crisis period and at any other time is removed. This means that under German law, and subject to a few exceptions, all shareholder loans are automatically subordinated, irrespective of whether the company was distressed at the time when the loan was advanced. In the wake of the 2008 reform, the BGH confirmed that "[s]ince the repayment of shareholder loans is contestable regardless of their purpose and regardless of the company's

98 BGH, Urteil vom 26 März 1984 - II ZR 171/83.

99 BGH, Urteil vom 7 November 1994 - II ZR 270/93.

100 K. Schmidt, Vom Eigenkapitalersatz in der Krise des Eigenkapitalersatzrechts? GmbH-Rundschau, 2005, s. 798.

101 Gesetz zur Modernisierung des GmbH-Rechts und zur Bekämpfung von Missbräuchen (MoMiG) vom 23. Oktober 2008. See § 39(1)(5) InsO.

economic situation, the affiliated group companies cannot invoke the lack of responsibility for the consequences of financing."[102]

Re-interpreting the responsibility for the consequences of financial decisions in light of the 2008 reforms, Bork argues that these reforms introduced an irrebuttable presumption of a crisis if shareholders finance their company through loans. According to him, "if the company needs money, it normally receives it on the market. If it obtains the loan from its shareholders instead of the market, it is irrefutably presumed that it is in the "crisis" and in urgent need of equity capital [*Eigenkapital*]".[103] Some commentators do not support this line of reasoning, noting that it is somewhat artificial.[104]

7.5.3 Risk re-allocation and risk shifting

The third argument revolves around the distinct characteristics of shareholders and the levels of risk taken by internal and external creditors (see section 7.3.3.). The argument states that by choosing to extend a loan instead of making an equity contribution, a shareholder gets protection in case the debtor fails, while at the same time benefitting from potentially unlimited growth if it succeeds.[105] This problem is inherent in the corporate form, where shareholders do not internalise losses and costs of failure due to limited liability.[106] The risk re-allocation feature of shareholder loans was vividly described in *In re V. Loewer's Gambrinus Brewery Co.*, dealing with loans provided by a creditor who had the same shareholders as the borrower:

---

102 BGH, Urteil vom 21 Februar 2013 – IX ZR 32/12. The BGH continues to recognise the responsibility for the consequences of financial decisions as a reason for the special treatment of shareholder external financing under insolvency law.

103 R. Bork, Abschaffung des Eigenkapitalersatzrechts zugunsten des Insolvenzrechts? *ZGR* 2007, s. 257. For a similar position, see H. Altmeppen, Das neue Recht der Gesellschafterdarlehen in der Praxis, *NJW* 2008, s. 3602. Also, H. Hirte, InsO § 39 Nachrangige Insolvenzgläubiger. Uhlenbruck, Insolvenzordnung: InsO. 15. Auflage 2019, noting that there is an irrefutable presumption of the abusive nature of loans granted by shareholders, even if such loans are granted prior to the crisis. For a different view, see M. Kampshoff, Behandlung von Bankdarlehen in der Krise der GmbH, GmbHR 2010, 897, arguing that the reason for subordination lies in the proximity of the shareholder to the company, the associated information advantage and a greater scope for influence.

104 C. Behme, InsO § 39 Nachrangige Insolvenzgläubiger, Münchener Kommentar zur Insolvenzordnung, 4. Auflage 2019, Rn. 42-47, stating that the crisis presumption is pure fiction; T. Fedke, Konzerninnenfinanzierung nach dem MoMiG in insolvenznahen Szenarien, *NZG* 2009, 928.

105 R.J. de Weijs, M. Good, Shareholders' and creditors' entitlements on insolvency: who wins where? Butterworths Journal of International Banking and Financial Law, November 2015, p. 643, observing that shareholder loans "dramatically change the risk profile of the company" and prompt "shareholders to have the company make riskier investments."

106 E. Ferran and L.C. Ho, Principles of Corporate Finance Law, OUP, 2014, p. 11.

> Both the shareholders and the creditors in any enterprise assume some risk of its failure, but their risks are different. The shareholders stand to lose first, but in return they have all the winnings above the creditors' interest, if the venture is successful; on the other hand the creditors have only their interest, but they come first in distribution of the assets. Beneficially considered, the same persons are both creditors and shareholders, when they have organized into two corporations under a single control. If in such a case they are allowed to prove in insolvency on a parity with other creditors, as shareholders of the debtor they can use their control to take all the winnings which may be made on their advances while the company is successful, yet they will expose themselves only to creditors' risks, if it fails. […] To compel [an outside creditor] to divide the assets in insolvency with those who at their option have all along had power to take all the earnings, is to add to the risk which he accepted.[107]

The risk-bearing nature of equity contributions creates an incentive for shareholders to monitor management and engage in corporate governance.[108] Equating the position of shareholders with that of creditors leads to risk re-allocation and weakens the said incentive. The risks are effectively externalised from shareholder to creditors. Subordination rules aim to restore the shareholder-creditor balance and create a disincentive to pursue inefficient and unjustifiably risky strategies, and engage in what is known as "gamble for resurrection". According to the BGH, subordination rules seek to prevent shareholders from passing the associated financing risks to outside creditors. The BGH argues that a shareholder "should not be allowed to speculate at the expense of the company's creditors in the expectation of being able to get his money to safety in due time due to better information possibilities."[109] Nevertheless, the BGH clarifies that the information advantage of a shareholder is not the decisive reason for subordination of a loan granted by it.[110] Therefore, the presence of contractual covenants, granting a creditor (e.g. a bank) certain information and control rights usually does not lead to subordination.[111]

---

107 *In re V. Loewer's Gambrinus Brewery Co.*, 167 F.2d 318 (2d Cir. 1948).

108 L. Gullifer, J. Payne, Corporate Finance Law: Principles and Policy, 3rd edn, Hart Publishing, 2020, p. 78, noting that it is the "ordinary shareholders, rather than the creditors, who will benefit from the capital gains that flow from the company's success, but they will also lose first should the enterprise fail". These factors give shareholders "the incentive to monitor management, and it is for this reason that company law gives the shareholders a significant corporate governance role."

109 BGH, Urteil vom 26 März 1984 - II ZR 171/83; BGH, Urteil vom 26 November 1979 - II ZR 104/77, noting the risk shifting function of shareholder loans.

110 BGH, Urteil vom 17 Februar 2011 – IX ZR 131/10. The BGH accepted that the information advantage can result in a loan being withdrawn before insolvency becomes apparent. Such a withdrawal is addressed by § 135 and not § 39 of InsO. In other words, the information and control advantages of shareholders may be addressed by means other than subordination.

111 BGH, Urteil vom 6 April 2009 – II ZR 277/07.

Continuing with the shareholder-creditor divide, it is pointed out that combining the roles of a creditor and a shareholder, especially if the shareholder's claim is secured, distorts the operation of transaction avoidance rules and contravenes the fundamentals of insolvency law.[112] The argument goes that if shareholders can establish security rights over corporate assets and thereby guarantee re-payment of (a part of) their investment, insolvency transaction avoidance rules and rules prohibiting pre-insolvency payment of dividends could lose their relevance. Insiders will simply have no need to engage in behaviour to extract undue benefits. For example, in the bankruptcy proceedings of the Dutch retail chain V&D, the ultimate shareholder, the US private equity firm Sun Capital, had security over almost all V&D's assets.[113] As a result, it could satisfy its claims in priority to other creditors whose claims were unsecured. This demonstrates that the idea that in insolvency, creditors are residual claimants and shareholders lose their ownership stake[114] does not match the practice of preserving shareholder control and ownership through a combination of a shareholder and creditor status.

Be it as it may, in Germany, there are some exceptions to subordination rules that are not easy to reconcile with the risk shifting argument or the idea of switching roles in governance and ownership. The first exception relates to the degree of control over the debtor. Thus, loans provided by shareholders holding no more than 10% of the equity stake and who are not involved in the management of the company are exempted (small participant privilege).[115] Yet, small shareholders equally benefit from the upside and have little or nothing to lose in the downside – their equity is wiped out in insolvency. Their risk appetite could be similar to that of majority shareholders. The second exception relates to distress financiers – investors with-

112 R.J de Weijs, Harmonization of European Insolvency Law: Preventing Insolvency Law from Turning against Creditors by Upholding the Debt-Equity Divide, ECFR, 2, 2018, p. 424, stating that subordination fits into the overall framework of insolvency law, including the rules on transaction avoidance and dividend payments. According to De Weijs, these rules become moot, if shareholders can guarantee the return through secured lending. For an overview of arguments in favour and against subordination, see R. de Weijs, J. de Vries and A. Jonkers, Corporate Finance for Lawyers, Edward Elgar Publishing, 2023, Chapter 6.

113 Public report dated 10 December 2019 pursuant to Article 73A Bankruptcy Act, 9th public report in insolvency of V&D <https://florent.nl/wp-content/uploads/2019/12/VD-en-LP-Verslag-09-EN.pdf> (accessed 15 July 2023). Shareholder claims were also fully secured in insolvency of another Dutch company McGregor. See Combined 1st public report of 1 September 2016 - McGregor Fashion Group Holding B.V. <https://cms.law/nl/media/local/cms-dsb/files/bankruptcies/combined-1st-public-report-of-1-september-2016-mcgregor-fashion-group-holding-b.v.-english?v=4> (accessed 15 July 2023).

114 J. Armour, G. Hertig and H. Kanda, Transactions with creditors, in R. Kraakman et al. (eds), The Anatomy of Corporate Law, OUP, 2017, p. 109.

115 InsO, § 39(5).

out a prior equity stake who acquire a stake in the course of restructuring, usually as a result of the debt-to-equity swap (restructuring privilege).[116] By investing in the financially distressed company, often at discounted rates, such investors may be driven by potentially unlimited growth, should the restructuring succeed.[117] These exceptions show that when it comes to subordination, the shareholder-creditor divide is not bulletproof, even in countries with rigid subordination rules.

7.5.4 Value-enhancing and value-destroying rescue attempts

Intra-group financial support may facilitate efficient restructuring. It is widely recognised that businesses need money, and struggling businesses need it the most. Money is required to support the continued operation of the debtor during its negotiations with creditors and to implement the restructuring plan upon confirmation. Preservation of operational continuity may be equally important when contemplating the sale of the business as a going concern, as any interruption might result in a reduction in its price. Access to funds is critical to ensure business continuity and timely payments to critical suppliers of goods and services, lessors, employees, insurance providers, and other stakeholders.[118]

In groups of companies, a common source of funds could be within the group and include both solvent group entities and group members already subject to insolvency proceedings. For illustrative purposes, the Singapore case is of interest. Based on the mix of empirical data and case studies on Singapore schemes in the period of 1996-2019, Wan et al. have observed that "when companies are approaching insolvency or financial distress, controlling shareholders do not unnecessarily hold out; […] they add value (in the provision of financial support) and are often critical to the success of restructuring efforts."[119] The authors conclude that new financing by controlling shareholders is one of the conditions or essential predictors of the effectiveness of schemes.[120]

116 InsO, § 39(4).
117 W. Meilicke, Das Eigenkapitalersatzrecht - eine deutsche Fehlentwicklung, GmbHR, 2007, s. 225-236.
118 UNCITRAL Legislative Guide, Part two, Ch. II, para. 94.
119 W.Y. Wan, C. Watters and G. McCormack, Schemes of Arrangement in Singapore: Empirical and Comparative Analyses, American Bankruptcy Law Journal, Vol. 94, 2020, p. 486.
120 Ibid., p. 502.

The value of new financing is not simply intuitive. A positive effect of rescue financing on the chances of business survival is highlighted in a number of empirical studies.[121] Some of them conclude that debtors with debtor in possession (DIP) financing are more likely to successfully emerge from Chapter 11 compared to the companies that did not receive such financing.[122] The positive impact of post-petition financing on reorganisation is accepted by the American Bankruptcy Institute (ABI) Commission to Study the Reform of Chapter 11 (ABI Commission). It recognised the need for a robust and competitive post-petition financing market and the value that it provides to distressed firms.[123] The importance of rescue financing is also pointed out in the non-US context.[124] Tsioli emphasises that rescue financing "counteracts potential value-destructive 'lingering' of the case, moves it along more briskly and as such helps preserve the debtor's going concern value."[125]

What are the effects of subordination?

In the analysis of the economic effects of subordination rules, Gelter argues that "[even] though subordination has some beneficial effects, it deters some desirable rescue attempts and is an insufficient deterrent for some

121 The term "rescue financing" is mainly used in the EU and the UK, whereas the term "DIP financing" is prevalent in the USA.

122 S. Dahiya et al., Debtor-in-possession financing and bankruptcy resolution: Empirical evidence, Journal of Financial Economics, Vol. 69, 2003, pp. 259-280, finding that DIP-financed companies had a shorter reorganisation period. The authors did not find evidence of overinvestment (e.g. the undertaking of risky projects and projects with negative NPV). U.S. Dhillon, T. Noe and G.G. Ramírez, Debtor-in-possession financing and the resolution of uncertainty in Chapter 11 reorganisations, Journal of Financial Stability, Vol. 3, 2007, pp. 238-260, concluding that DIP financing resolves information asymmetries regarding the value of the firm and is correlated with successful reorganisations.

123 ABI Commission to Study the Reform of Chapter 11, Final Report and Recommendations, 2014, p. 77.

124 L. Stanghellini et al. (eds), Best Practices in European Restructuring. Contractualised Distress Resolution in the Shadow of the Law, Wolters Kluwer, 2018, p. 60, referring to Italian quantitative and qualitative analysis, underlining the importance of new financing to rescue businesses in distress. It is observed that commonly new finance comes from the debtor's shareholders.

125 L. Tsioli, Rescue financing under a 'viability spotlight', Journal of Corporate Law Studies, Vol. 22, 2022, p. 858. Tsioli also highlights the risks related to the exercise of creditor control through DIP financing.

undesirable ones."[126] A similar argument was made by other scholars.[127] For instance, Van Zwieten notes that "a rule mandating the subordination of related party creditor claims would likely limit the availability of insider capital even in circumstances where it might reasonably be expected to increase firm value […]."[128] She points out that a rule that imposes mandatory subordination of related party debt claims "seems highly unattractive, given the potential for related party loans to be value-enhancing for the firm."[129] De Weijs, who generally supports subordination, still notes that the prevention of desirable rescue attempts is "[o]ne of the strongest and most serious critiques as to subordination rules relates to rescue attempts."[130]

Relying on a statistical hypothesis testing, Gelter distinguishes two types of errors relevant for subordination. Type I error occurs if inefficient (negative expected value) rescue attempts are not prevented, so that the life of a dying business is artificially extended (overinvestment). This leads to the accumulation of debt and results in a dissipation of the firm's value to the detriment of creditors. Subordination partly internalises risk with shareholders and can therefore facilitate a timely exit of inefficient firms from the market.[131] Type II error arises where efficient firms are liquidated instead

126 M. Gelter, The subordination of shareholder loans in bankruptcy, International Review of Law and Economics, Vol. 26, 2006, p. 478.

127 S. Mba, New Financing for Distressed Businesses in the Context of Business Restructuring Law, Springer, 2019, p. 55, noting with respect to the German approach that "it would appear that the law does not countenance the need to support the superstructure on which informal distress financing rests, one of which is the provision of restructuring financing and an increasingly important source of this financing being insider/shareholder financing." See also H. Eidenmüller, Comparative Corporate Insolvency Law, in J.N. Gordon, W-G. Ringe (eds), The Oxford Handbook of Corporate Law and Governance, OUP, 2018, p. 1024, stating that "a subordination rule discourages debt financing by shareholders if the company is in financial distress, and the shareholders may be the only available financing source in such a setting. As a consequence, the prospects for a restructuring of the firm might be greatly reduced." M.R. Tucker, Debt Recharacterization During an Economic Trough: Trashing Historical Tests to Avoid Discouraging Insider Lending, Ohio State Law Journal, Vol. 71, 2010, p. 191, arguing that "[c]ourts must not inadvertently prohibit a company's most readily available source of funding [insider financing] by imposing on insiders an unreasonable fear of loan invalidation because of the existing capricious doctrine of debt recharacterization."

128 K. van Zwieten, Related Party Transactions in Insolvency, in L. Enriques and T.H. Tröger (eds), The Law and Finance of Related Party Transactions, CUP, 2019, p. 275.

129 Ibid., p. 274. According to Van Zwieten, a more attractive route to prevent misuse of related-party transactions is a director-targeting personal liability rule. A similar position is taken by Eidenmüller.

130 R.J. de Weijs, Hybrid finance by means of shareholder loans, in R. de Weijs, J. de Vries, A. Jonkers, Corporate Finance for Lawyers, Edward Elgar Publishing, 2023.

131 M. Gelter, The subordination of shareholder loans in bankruptcy, International Review of Law and Economics, Vol. 26, 2006, p. 486.

of being saved (underinvestment).[132] The extent or degree to which subordination reduces overinvestment and increases underinvestment is not entirely clear,[133] and requires empirical evaluation. Yet assuming that there are instances where subordination discourages the provision of intra-group loans to economically viable group entities and thereby prevents efficient rescue attempts (i.e. Type II error), the overall outcome may be detrimental to social welfare. Armour, Hertig and Kanda explain this by noting that:

> The rationale [of subordination] is to deter overinvestment in distressed firms, but such doctrines must walk a tightrope between deterring this and permitting controlling shareholders to make legitimate efforts to rescue failing firms through the injections of new debt capital. Perhaps reflecting these difficulties, this doctrine is not applied in France or the UK.[134]

This is why, for instance, following the recent reforms seeking to encourage shareholders to provide loans to their distressed companies, subordination rules were weakened in Italy. Under reformed Italian law, subordination does not apply to claims of shareholders and other parties exercising direction and control over the debtor arising from loans and guarantees granted by them for the purposes of a *concordato preventive* or debt restructuring agreement up to 80% of the original claim.[135] In this 80%-part, financing is subject to the special regime of *prededuzione*, which gives priority over unsecured creditors. The remaining 20% is subordinated. By contrast, while the German StaRUG allows a plan to incorporate new financing agreements, including those from shareholders (shareholder loans), if the debtor subsequently enters bankruptcy proceedings, shareholder loans under the plan remain shareholder loans, which means that they are subordinated in insolvency distribution (§ 39(1)(5) InsO). Besides, security granted to subordinated debt is widely avoidable.[136]

The difficulty lies in finding a balance between preventing overinvestment in economically non-viable enterprises through intra-group loans, on the one hand, and protecting and encouraging those transactions which aim at value creation and efficient allocation of resources and liquidity within

---

132 Ibid. Gelter seems to view subordination as a way of penalising shareholders. See ibid., p. 479.

133 S. Landuyt, A Capital Question, A Capital Question, Should Shareholder Loans be Automatically Subordinated?, in D. Bruloot (ed), Belgian and European perspectives on creditor protection in closed companies, Intersentia, 2019, p. 142, arguing that it is "unlikely that in case of the subordination of shareholder loans the costs of the underinvestment problem will outweigh the benefits generated by the deterrence of excessive risk-taking."

134 J. Armour, G. Hertig and H. Kanda, Transactions with creditors, in R. Kraakman et al. (eds), The Anatomy of Corporate Law, OUP, 2017, p. 132.

135 Codice della crisi d'impresa e dell'insolvenza (Decreto Legislativo 12 gennaio 2019, n. 14), Articles 102(1) and 292(2).

136 InsO, §135.

the group, on the other hand. Our view is that blanket subordination of all insider loans does not establish such balance, as it does not distinguish between value-enhancing and value-destroying rescue attempts. In other words, it may be disproportionate.

Facilitation of intra-group loans in a situation of financial distress (absent external financing on comparable terms) can contribute to the maximisation of enterprise value and preservation of the debtor's business, from which outside creditors and other stakeholders, like employees, can benefit. The sole fact that financing comes from an insider does not change this. However, to mitigate the risk of inefficient rescue attempts and externalisation of costs, a supervised and controlled legal framework for rescue financing may be considered (see Chapter 12). Should the law provide for subordination, this framework might ensure that if the rescue attempt has a positive expected value, subordination does not follow. This would mitigate the problem of underinvestment while discouraging overinvestment.

7.6 Conclusion

In the beginning of this chapter, we compared intra-group, inward-looking financing to the blood flows within a human body. Just like the circulatory system, wherein blood circulates and transports nutrients, such as amino acids and oxygen, to different organs of the body, the provision of capital and liquidity to constituent group entities could be vital for their continued operation and survival. A centralised cash management or cash pooling system, typical for many large enterprise groups like Lehman Brothers, may be seen as the closest analogue to the circulatory system (to the extent that it is possible to compare a living organism with an artificial construct such as a legal entity or an enterprise group). This chapter focuses on intra-group loans, which constitute a common way to re-allocate liquidity within groups of companies.

One issue that is specific to intra-group loans is their potential subordination in insolvency. It means that shareholder loans are repaid after unsecured creditors. It has been shown that countries adopt very different approaches to the issue of shareholder loan subordination. While countries like Germany, Brazil and Spain have strict subordination rules mandating subordination in almost all cases, in the UK, only sums due to a shareholder "in his character of" a shareholder, narrowly interpreted (e.g. dividends), are subject to subordination. In the USA, the doctrines of equitable subordination and debt recharacterization were developed over time. The former is codified in § 510(c) of the US Bankruptcy Code, seeking to remedy inequitable conduct and restore justice among creditors. The latter is not explicitly based on the statute, has unclear boundaries, and relies on different multi-factor tests to determine whether a loan was meant and should be treated

as an equity contribution. In the Netherlands, there is no settled stance on subordination. The Dutch Bankruptcy Act does not contain rules prescribing subordination, leaving the narrow possibility to subordinate insiders' claims in situations involving improper conduct or behaviour violating the standards of reasonableness and fairness.

The wide range of approaches to subordination of insider loans is underpinned by a variety of views on the pros and cons of subordination (section 7.5.). Some authors argue that subordination facilitates timely insolvency filings and exit of economically non-viable firms from the market. It is also suggested that subordination could respond to risk-shifting behaviour of shareholders, prevent the externalisation of losses, promote better corporate governance, and preserve creditors' status as residual claimants in insolvency. These arguments reflect the differences between internal and external creditors, discussed in section 7.3. At the same time, other scholars note that a non-subordinated shareholder loan aligns the interests of a shareholder with those of external creditors, whereas the risks of misuse of related-party transactions are better tackled by transaction avoidance and directors' liability rules. UNCITRAL adds that subordination might threaten the viability of the subordinated group entity (as it is likely to receive nothing in the insolvency of the borrower), harm its creditors and cause detriment to the reorganisation of the group as a whole.[137]

Perhaps the strongest and most important criticism of subordination is that it is overreaching and disproportionate, and that it discourages efficient, value-enhancing rescue attempts. There is nothing morally reprehensible about intra-group loans. However, there is a thin line between, on the one hand, deterring overinvestment in inefficient, economically non-viable enterprises and combating group opportunism, and on the other hand, encouraging insiders (e.g. group entities) to make legitimate and value-creating efforts to save financially distressed but economically viable firms, mitigating the problem of underinvestment and contributing to the preservation and maximisation of estate value. Finding a balance is crucial in the context of rescue financing – financing extended to a struggling company to ensure the continuity of its operations during negotiations of a restructuring plan with creditors or necessary for the implementation of the plan.

137 UNCITRAL Legislative Guide, Part three, Ch. II, para. 88. See similarly, I. Mevorach, Transaction Avoidance in Bankruptcy of Corporate Groups, ECFR, Vol. 8, 2011, p. 251, noting that the "prospect of equitable subordination of intra-group debts increases the risk of non-payment to the subordinated party and therefore induces the creditors of that company to investigate the other affiliates' creditworthiness."

8 Facing Uncertainty: Intra-group Financing and Transaction Avoidance▪

8.1 Introduction

In many jurisdictions, transactions between or involving group entities may face increased scrutiny, as do other related-party transactions[1] – especially if such transactions are concluded in the vicinity of insolvency. This is a common approach across many national legal systems.[2] It can be attributed to the information asymmetry that often exists between internal (related) and external (non-related) creditors (see section 7.3.). The former usually have a better awareness of the debtor's financial situation. In the group context, this awareness concerns the financial soundness of group entities and the entire group. Additionally, due to their control advantage and risk-shifting incentives in the vicinity of insolvency, shareholders can be incentivised and have the power to engage in value-destroying behaviour, be it in the form of overinvestment or value extraction.[3] The value extraction might be arranged through various means, from a transfer at an undervalue, assumption of liability, to a preferential payment of intercompany debt, e.g. via

---

▪ This chapter builds upon the following previously published work by the author:
- I. Kokorin, S. Madaus and I. Mevorach, Global Competition in Cross-Border Restructuring and Recognition of Centralized Group Solutions, Texas International Law Journal, Vol. 56(2), 2021, pp. 109-154.
- I. Kokorin, The Future of Harmonisation of Directors' Duties in the EU: Restructuring Directive and Group Insolvencies, International Insolvency Review, Vol. 30, 2021, pp. 361-382.
- I. Kokorin, Intra-Group Financial Support in a Crisis: Between Rescue and Abuse, Norton Journal of Bankruptcy Law and Practice, Vol. 29, 2020, pp. 378-420.

1 UNCITRAL Legislative Guide, Part two, Ch. II, para. 182.

2 Control over related-party transactions is not limited to the area of insolvency law. For example, it surfaces in the rules imposing prohibitions and introducing procedural safeguards, mandatory disclosures, requirements for external independent advice, and ex post standard-based judicial review. L. Enriques, Related Party Transactions, in J.N. Gordon, W-G. Ringe (eds), The Oxford Handbook of Corporate Law and Governance, OUP, 2018, pp. 506-531.

3 R.J. Mokal, Corporate Insolvency Law: Theory and Application, OUP, 2005, p. 307, explaining that "in the twilight period while the company is distressed but not yet subject to formal insolvency proceedings, its assets are under the control of decision-makers who do not have the correct incentives to use them so as to benefit the company's new residual owners [creditors]."

setting-off an intercompany claim. There are other examples of transactions that could be detrimental to external creditors of separate group entities.[4]

The danger of group opportunism is only a part of the picture. Related-party transactions are not *per se* problematic in the sense that they do not always or often harm the collective interest of creditors. Intra-group loans may facilitate efficient allocation of liquidity within the group and mitigate the problem of underinvestment (lack of incentives to finance value-creating projects). Cross-guarantees are used to secure beneficial conditions (e.g. lower interest rates and larger amounts) from outside lenders and help address the debt overhang problem (a situation where the firm's high debt levels act as a disincentive to new investment). Both intra-group loans and cross-guarantees promote financing – whether from inside or outside the group. The previous chapter noted that subordination disincentivises intra-group lending. This chapter focuses on transaction avoidance.

Transaction avoidance can have an economic effect similar to that of subordination as both of them increase credit risk for a counterparty.[5] This follows from the fact that subordination and transaction avoidance rules limit "the ability of debtors to engage in the transactions in the first instance."[6] The word "ability" is not used here in the factual sense (parties may still proceed with a transaction at their own risk), but rather in the economic sense. Transaction avoidance creates a chilling or deterrent effect. A financier is likely to be reluctant to finance restructuring efforts if he has to face transaction avoidance, should the restructuring attempt fail. Think of an intra-group guarantee. Will an external creditor, like a bank, be willing to grant a loan to a distressed group entity, knowing that the guarantee offered by another group entity is likely to be avoided if the guarantor itself ends up in insolvency? On this, Mevorach argues that routine attacks on intra-group guarantees in insolvency "may deter lenders from providing funding in circumstances where the only security can be given by an affiliate know-

4 One such example is conduit pipe financing. See R. de Weijs, M. Baltjes, Opening the Door for the Opportunistic Use of Interim Financing: A Critical Assessment of the EU Draft Directive on Preventive Restructuring Frameworks, International Insolvency Review, Vol. 27, 2018, p. 227, describing a situation where the granting of finance is not intended for the benefit of the recipient company but is instead used to pay off the debts for which the shareholder gave a guarantee. Also H. Bennett, Late Floating Charges, in J. Armour, H. Bennett (eds), Vulnerable Transactions in Corporate Insolvency, Hart Publishing, 2003, p. 201.

5 A. Muscat, The Liability of the Holding Company for the Debts of its Insolvent Subsidiaries, Dartmouth Publishing Company, 1996, p. 238, viewing equitable subordination as a functional substitute to fraudulent conveyance law.

6 D.G. Baird and T.H. Jackson, Fraudulent Conveyance Law and Its Proper Domain, Vanderbilt Law Review, Vol. 38, 1985, p. 834, pointing out that "in considering a legal rule such as fraudulent conveyance law, overbroad rules may be more pernicious than underbroad rules."

ing that the guarantee is likely to be attacked in the case of the guarantor liquidation."[7]

Yet cross-guarantees present substantial problems for transaction avoidance law, precisely because they are often driven by group interest and might not entail clear and direct benefits to group guarantors. This chapter examines the application of transaction avoidance rules and logic to intercompany guarantees as an example of a widely used group financing transaction. Section 8.2. examines national transaction avoidance law and concludes that legal uncertainty is inherent in the review of intercompany guarantees. This uncertainty relates to the acceptance of group economic reality or "group considerations" in transaction avoidance. Section 8.3. explores the difficulties of ex post review of intra-group transactions. Section 8.4. concludes.

8.2 "Group Considerations" in Insolvency Transaction Avoidance

8.2.1 Transaction avoidance and group specificity

The issue of validity and enforceability of cross-guarantees is of crucial importance. It makes a huge difference in terms of the size of creditor recovery and the overall dynamics of group insolvency. Historically, the review of transactions has fallen under the domain of transaction avoidance law. Roman law knew a remedial action for the rescission of conveyance in fraud of creditors, commonly known as *actio Pauliana*.[8] This action was available both in and outside insolvency.[9]

Transaction avoidance rules contribute to the achievement of various principles of insolvency law. Most notably, they seek to protect creditors from the diminution of assets available to them in insolvency, thereby promoting the preservation and maximisation of the insolvency estate value and ensuring equal treatment of creditors.[10] UNCITRAL identifies three types of transac-

7 I. Mevorach, Insolvency within Multinational Enterprise Groups, OUP, 2009, p. 293. Also I. Mevorach, Transaction Avoidance in Bankruptcy of Corporate Groups, ECFR, Vol. 8, 2011, p. 249, observing that "in a group scenario it may well be that intra-group guarantees […] are the only way to secure any credit for the distressed affiliate and gain breathing-space for the group as a whole."

8 R. Obenchain, The Roman Law of Bankruptcy, The Notre Dame Lawyer, Vol. 3, 1928, p. 200.

9 I. Pretelli, Cross-Border Credit Protection Against Fraudulent Transfers of Assets: Actio Pauliana in the Conflict of Laws, Yearbook of Private International Law, Vol. 13, 2011, p. 595, noting that the remedy was available to both *curator bonorum* and the creditors individually.

10 K. van Zwieten, Goode on Principles of Corporate Insolvency Law, 5th student edn, Sweet & Maxwell, 2019, para. 13-03, explaining that "avoidance provisions may thus be seen as necessary both to preserve the company's net assets and to ensure equality of distribution, at least among classes of creditors."

tions that are subject to avoidance, found in most legal systems: (i) transactions intended to defeat, hinder or delay creditors from collecting their claims; (ii) transactions at an undervalue; (iii) preferential transactions.[11] The existence of different grounds for invalidating transactions (transaction avoidance risk) can influence parties' willingness to engage in a transaction in the first place. For example, a financier may decide not to grant a loan if there is a high risk that a group guarantee that should secure the loan might be successfully challenged in the future. This becomes problematic if the "averted" loan transaction was, in fact, a value-creating one.

In this chapter, we do not aim to offer a detailed account of transaction avoidance law in specific jurisdictions.[12] Given the constraints of space and the main focus of this book, our attention is on group specificity. The central question revolves around the recognition and treatment of the group reality within the context of transaction avoidance law. Why does it matter? UNCITRAL observes that:

> Some transactions that might appear to be preferential or undervalued as between the immediate parties might be considered differently when viewed in the broader context of an enterprise group, where the benefits and detriments of transactions might be more widely assigned.[13]

In other words, the benefits and detriments of an intra-group transaction can be affected by the sheer economic position of the debtor within the group. Let's consider an example of a subsidiary that extends a guarantee benefitting a parent company. The guarantee may be a precondition for an external lender to provide financing to the parent company, or it may allow the parent company to negotiate better credit terms. While the subsidiary may not directly benefit from this transaction, it could still benefit indirectly by preserving the borrower's solvency, preventing the triggering of cross-defaults, ensuring a steady supply of goods and services from the borrower, or for other group-related reasons.[14]

---

11 UNCITRAL Legislative Guide, Part two, Ch. II, para. 170.

12 For an overview of national approaches to transaction avoidance in insolvency law, see R. Bork and M. Veder, Harmonisation of Transactions Avoidance Laws, 1st edn, Intersentia, 2022.

13 UNCITRAL Legislative Guide, Part three, Ch. II, para. 75.

14 See an example of this reasoning in the Decision of the Russian Supreme Court No. 310-ЭС20-18954 from 25 March 2021 (*Spar Lipetsk*), holding with respect to liability of a director of a subsidiary, which provided a guarantee: "By itself, the issuance of such guarantees in favour of a credit institution insisting on additional security does not reveal the signs of unreasonableness or dishonesty in the behaviour of the guarantor's management […], even in a situation where the guarantor, acting in group interest and not with the purpose to injure creditors, assumes joint and several obligations to the bank in an amount exceeding its financial capabilities, believing that in the future the result of the group's activities will allow it to pay off the obligations of its members to creditors." (translation of the author).

Group-mindful application of transaction avoidance rules becomes particularly important in the context of insolvency and pre-insolvency rescue financing. In this respect, the World Bank opines that insolvency systems should "permit an enterprise group member subject to insolvency proceedings to provide or facilitate post-commencement finance or other kind of financial assistance to other enterprises in the group which are also subject to insolvency proceedings."[15] Similarly, UNCITRAL argues that insolvency law should permit an enterprise group member subject to insolvency proceedings to advance post-commencement finance to other group entities subject to insolvency proceedings, or grant security interest or guarantee in their favour.[16]

The reasoning is that in specific circumstances, however limited they may be, intra-group support provided by one insolvent group member to another insolvent group member may serve the interests of both of them, e.g. by ensuring continued operation or survival of the providing entity's business or preserving and enhancing its estate value.[17] UNCITRAL asserts, more generally, that the assessment of short and long-term implications for group members should permit, even if only in the short term, some detriment to the interests of an individual group entity and its creditors (short-term harm v. long-term gain).[18] Nevertheless, this does not mean that group interest can serve as a cover-up or justification for intra-group transactions that injure the creditors of an individual group entity, where a short-term detriment is *not* offset by long-term gain.

The next sections will examine the position of English, US and Dutch law on transaction avoidance in group insolvencies. It is impossible to analyse all types of transactions. This is why we will focus on a cross-guarantee, as a transaction common in group financing (Chapter 6). This type of transaction is challenging to evaluate from the perspective of an individual group company that incurs a contingent obligation to pay to a guaranteed creditor. In fact, it may appear as a pure gift with no consideration being paid to the guarantor.

15 The World Bank, Principles for Effective Insolvency and Creditor/debtor Regimes, 2021, C16.2.

16 UNCITRAL Legislative Guide, Part three, Recommendations 211-213.

17 Ibid., Ch. II, para. 66. See also para. 71, adding that the particular interest of the providing entity may relate to the outcome for the entire group, especially if there is a high degree of integration and reliance between businesses of the group entities.

18 UNCITRAL Legislative Guide, Part four, Section two, para. 4.

8.2.2 The UK: measuring the value for the creditor and guarantor

Section 238 of the Insolvency Act 1986 provides that if a company has entered into a transaction at an undervalue at a relevant time (i.e. within two years ending with the onset of insolvency),[19] an IP may apply to the court for relief, restoring the position to what it would have been if the company had not entered into that transaction. Importantly, the law adds that the debtor must be unable to pay its debts at the relevant time or should become unable to do so in consequence of the transaction – only then the time becomes "relevant".[20] The inability to pay debts is presumed, unless the contrary is demonstrated, if the transaction is entered into by a person who is connected to the debtor company.[21]

The Insolvency Act 1986 specifies that a transaction at an undervalue could be a gift (i.e. transfer of an asset for no consideration) or a contract for no consideration (e.g. a voluntary release of a debt), or a disposition for consideration worth significantly less than the value of the return consideration.[22] It is recognised that a guarantee transaction is not a gift or a no-consideration contract, even if the recipient of funds from the creditor – the borrower-principal debtor – is a different entity and the objective value of the advance to the guarantor is nil.[23] In fact, the consideration is the advance made to the borrower because this is "the act exacted by the surety as the price of his guarantee."[24] The fact that the advance is made to the principal debtor and not to the guarantor does not in itself render the guarantee a transaction at an undervalue.[25]

Besides, not every undervalued transaction can be avoided. Section 238(5) of the Insolvency Act 1986 provides a defence on the basis that there may be a legitimate reason for a party, such as a guarantor, to enter into a transaction at an undervalue. This defence applies if the transaction is entered into:

---

19 Insolvency Act 1986, section 240(1).

20 Insolvency Act 1986, section 240(2).

21 Ibid. For a definition of a "connected party", see section 249 of the Insolvency Act 1986, mentioning among such parties "an associate of the company". In most cases, group members will be associates of each other and therefore constitute connected parties. See section 435 of the Insolvency Act 1986. An outside lender will typically not be a connected party.

22 Insolvency Act 1986, section 238(4).

23 K. van Zwieten, Goode on Principles of Corporate Insolvency Law, 5th edn, Sweet & Maxwell, 2018, paras. 13-23 and 13-32; D. Spahos, Lenders, Borrowing Groups of Companies and Corporate Guarantees: An Insolvency Perspective, Journal of Corporate Law Studies, Vol. 1, 2001, p. 336.

24 K. van Zwieten, Goode on Principles of Corporate Insolvency Law, 5th student edn, Sweet & Maxwell, 2019, para. 13-32. See also J.G. Doyle, Insolvency Litigation, Sweet & Maxwell, 1999, p. 205.

25 Ibid. (Van Zwieten), para. 13-32.

(i) in good faith and for the purpose of carrying out the party's own business; and in the circumstances, where (ii) at the time there were reasonable grounds to believe that the transaction in question would benefit the party. The assessment of whether there were such reasonable grounds is done objectively. Yet, for the defence to be available, it is not necessary for the transaction to have been beneficial in practice. Both elements (good faith and propriety of purpose and reasonableness) must be established at the same time.[26] If any of the elements is not present, the transaction remains vulnerable.

The first question to answer is whether a cross-guarantee qualifies as a transaction at an undervalue. The "value" refers to the amount that a reasonably well-informed purchaser is willing, in arms' length negotiations, to pay for an asset.[27] Where there is a market for an asset, its value can be determined by comparing the price of a substitute asset in the market.[28] However, when the asset is unique, such a comparison may not be possible. Because there is generally no market for corporate guarantees, determining the guarantee's market value and equality of exchange is difficult.

According to Goode, the crucial question is "whether the benefit conferred on the creditor by the issue of the guarantee is significantly greater than the value to the surety of the advance to the principal debtor."[29] Therefore, the balancing exercise involves measuring the value of the guarantee to the creditor, on the one hand, and the value of the guaranteed financing for the guarantor, on the other hand.[30] Should there be a *significant* difference

26 *Wallach v. Secretary of State for Trade and Industry* [2006] EWHC 989 (Ch). The burden of proof in establishing the defence rests on the party seeking to defend the transaction against its avoidance under section 238.

27 *Phillips (Liquidator of AJ Bekhor & Co) v. Brewin Dolphin Bell Lawrie Ltd* [2001] 1 W.L.R. 143, at 30.

28 *Re Brabon, Treharne v. Brabon* [2001] B.C.L.C. 11, at 38; *Spencer v. The Commonwealth* (1907) 5 CLR 418, at 431.

29 R. Goode, Principles of Corporate Insolvency Law, 4th edn, Sweet & Maxwell, 2011, para. 13-34. Also R. Goode, L. Gullifer, Goode and Gullifer on Legal Problems of Credit and Security, 6th edn, Sweet & Maxwell, 2017, para. 8-37, pointing out that "in deciding whether a guarantee gives rise to a transaction at an undervalue the act which constitutes the transaction is the giving of the guarantee, not the creditor's subsequent call under the guarantee."

30 This line of thinking was adopted in *Tailby v. HSBC Bank Plc* [2015] B.P.I.R. 143 (case on s. 339), pointing out that the value of the guarantee was originally minimal, while at the same time there was a real commercial benefit to the guarantor on several levels. See *Levy McCallum Ltd v. Allen* [2007] N.I Ch. 3, where the principal borrower and the guarantor belonged to the same group of companies and the guarantor extended the guarantee trying to improve its chances of receiving payment from the principal debtor.

between these two values, the transaction avoidance rules are triggered.[31] This approach is unusual because the "value" of a transaction is commonly assessed from the viewpoint of the debtor company (in our case, a group guarantor), and not from that of the third party (in our case, an outside lender). For instance, in *MC Bacon*, Millett J. observed that the assessment of the transaction requires "a comparison to be made between the value obtained by the company for the transaction and the value of consideration provided by the company. Both values must be […] considered from the company's point of view."[32]

However, the case of a guarantee transaction is somewhat special. Given that a guarantee creates contingent liability that may never crystallise, its value to the creditor and guarantor are often linked or (negatively) correlated. The more value it brings to the creditor (i.e. the more protection it grants to the creditor), arguably the less value and the higher risk or exposure it entails for the guarantor. In this respect, Goode suggests the following factors relevant for the assessment of the guarantee's value:

- Principal debtor's financial strength. If the principal debtor's financial position is strong and is likely to remain strong, and the guarantee is unlikely to be called upon, it may be argued that such a guarantee is of relatively small value to the creditor.[33] This is because the creditor can receive the full satisfaction from the principal debtor. The principal debtor's financial strength also correlates with the level of the guarantor's risk. The stronger the principal debtor, the smaller the guarantor's risk.

---

31 D. Spahos, Lenders, Borrowing Groups of Companies and Corporate Guarantees: An Insolvency Perspective, Journal of Corporate Law Studies, Vol. 1, 2001, p. 338, highlighting that "only where the value of the impeached guarantee significantly exceeds the value of the economic benefit flowing to the surety will section 238 come into play." See, however, R. Bork, Transactions at an Undervalue – A Comparison of English and German Law, Journal of Corporate Law Studies, Vol. 14, 2014, p. 473, arguing that "[e]ven if indirect advantages, like the support of a parent company's interest in the financing of its subsidiary, are taken into account, these advantages will normally be of significantly less value than the security […]."

32 *Re MC Bacon Ltd (No. 1)* [1990] BCC 78, at 92.

33 K. van Zwieten, Goode on Principles of Corporate Insolvency Law, 5th student edn, Sweet & Maxwell, 2019, para. 13-33. Where the principal debtor is "on the rocks" and the guarantee merely staves off disaster, the guarantee will most certainly constitute a transaction at an undervalue (see para. 13-34). However, it is noted that in practice "it is unlikely that a guarantee will be impeached as a transaction at an undervalue except where it is clearly of no benefit to the surety company." For a similar position, see G.D. Vinter, Project Finance: A Legal Guide, 3rd edn, Sweet & Maxwell, 2006, p. 375. Also, R. Goode and L. Gullifer, Goode and Gullifer on Legal Problems of Credit and Security, 6th edn, Sweet & Maxwell, 2017, para. 8-37, concluding that "in the ordinary way a guarantee is unlikely to be held a transaction at an undervalue unless there is both a serious risk of default and no benefit to the surety […]."

- Existence of security (e.g. mortgage, charge) furnished by the principal debtor. When the principal debtor provides *in rem* security to the creditor, it not only improves the creditor's position but also positively affects the guarantor. If the guarantor ends up paying, it will have the right to be subrogated to the security held by the creditor, reducing the guarantor's risk.
- Presence of other guarantors guaranteeing the same obligation. If the guarantor pays in discharge of common liability, he generally acquires the right to seek contribution from the co-guarantors, who are likely to be members of the same group of companies. Again, this may reduce the risks for the paying guarantor.[34]

The second question is whether, even if there is an undervalue, the defence of section 238(5) of the Insolvency Act 1986 is available. Parry and Shivji consider this question in the context of intra-group support and conclude that there is nothing to prevent the defence from being applicable where one group entity makes a payment for the benefit of another group entity. Yet ultimately, what counts is the benefit received by the former and not the benefit enjoyed by the group as a whole.[35] Nevertheless, such benefit may arise from the fact that the receiving entity "needs funds in order to complete a particular contract so as to avoid liquidation and to avoid taking the entire group with it."[36] The common economic goal and survival of the entire group could be taken into account when evaluating the benefits of the transaction from the providing entity's perspective. However, if this entity itself is on the verge of insolvency or already insolvent, determining the benefit becomes challenging. It is difficult to assert that the payment was made to carry out *its own business* in such circumstances.[37] Similarly, if the group entity receiving intra-group support is irredeemably insolvent, particularly due to its business core being non-viable, the defence is more likely to fail.

---

34 K. van Zwieten, Goode on Principles of Corporate Insolvency Law, 5th edn, Sweet & Maxwell, 2018, paras. 13-33 and 13-34.

35 E. Ferran and L.C. Ho, Principles of Corporate Finance Law, 2nd edn, OUP, 2014, p. 35, noting that "since the interests of a failing company are identified with those of its own creditors rather than those of its shareholders or of the collective interests of the group's creditors, actions taken in the interests of the group will be particularly vulnerable under these sections [s. 238 and s. 239 Insolvency Act 1986]." *Re Genosyis Technology* [2006] EWHC 989 (Ch), at 25, drawing the line between the interests of the English group entity and those of other group entities with application to directors' duties.

36 R. Parry, S. Shivji, Transactions at an Undervalue (Insolvency Act 1986, Sections 238 and 339), in R. Parry et al. (eds), Transaction Avoidance in Insolvencies, 3rd edn, OUP, 2018, para. 4.166; A. Muscat, The Liability of the Holding Company for the Debts of its Insolvent Subsidiaries, Dartmouth Publishing Company, 1996, p. 232, noting that "many such guarantees should be saved from the clutches of section 238 on the basis of the defence [of section 238(5)]."

37 Ibid. (Parry and Shivji), para. 4.167.

The defence of section 238(5) can also apply to intercompany guarantees. For this to work, it must be demonstrated that the guarantor acted in good faith and had reasonable grounds to believe that the guarantee was for the guarantor's own benefit. The benefit received by the guarantor is, therefore, one of the key elements. In the group context, it may be the case that the guarantor receives an indirect benefit if its interests are aligned with or dependent on those of the principal debtor, and the guarantee was issues as part of a group restructuring – group-related benefit.[38]

The analysis of the benefits can be carried out for different types of guarantees: downstream, cross-stream, and upstream guarantees. For a downstream guarantee, it is easier to see the benefit, as it could arise from the enhancement of the subsidiary's position, in which shares are held by the parent company-guarantor. For a cross-stream guarantee, the situation is less straightforward. The benefit may emerge if the advance made to a sister company is made available to the guarantor or if it is used to refinance the entire group. Finally, assessing the guarantor's benefit for an upstream guarantee is a matter of considerable difficulty. Again, the benefit may be observed if the advance received by the parent is shared with the guarantor or if it is used to ensure group restructuring, upon which the guarantor's own survival is based. Another factor to consider is whether the guarantor receives a fee for providing the guarantee, which might salvage the guarantee from avoidance.[39] But then, there remains a question of whether the fee is adequate and whether the relevant values are *significantly* different, given the risks assumed by the guarantor.

In considering potential benefits to the guarantor, regard must be had to what the provision of a guarantee sought to achieve (i.e. the motives of the guarantor). Hence, if the guarantee was extended to support the principal debtor's gamble for resurrection[40] or its last-ditch attempt to avoid insolvency, regardless of how unlikely its success was, there may be little potential benefit for the guarantor. Instead, there is a real risk of the guarantee

38 Ibid., para. 4.171. See also J. Armour, Transactions at an Undervalue, in J. Armour, H. Bennett (eds), Vulnerable Transactions in Corporate Insolvency, Hart Publishing, 2003, p. 70, discussing indirect consideration in the context of an upstream guarantee and giving an example, where the subsidiary (guarantor) relies upon the parent company for much of its business and the guarantee is necessary for the parent's continued trading. For a sceptical view on group-related indirect benefits, see J. O'Donovan, Lender Liability, English edn, Sweet & Maxwell, 2005, para. 10.80, arguing that the "court may not value very highly the intangible benefits of operating in a group […]."

39 Ibid. (Parry and Shivji), para. 4.179. Note, however, that in most cases, the consideration for a guarantee consists entirely of some advantage given to the principal debtor by the creditor. This may include forbearance from suing the principal debtor or granting a loan to the principal debtor. G. Andrews, R. Millett, Law of Guarantees, 4th edn, Sweet & Maxwell, 2005, para. 2-008.

40 Posner refers to "gambling for resurrection" as the "incentive of a firm at risk of insolvency to roll the dice […]." R.A. Posner, The Crisis of Capitalist Democracy, HUP, 2010, p. 91.

being called in. The benefits and risk also depend on the presence of adequate security that the guarantor can "inherit" and on the existence of other guarantors. Of course, the real effect of these safeguards will depend on the value of the security and the financial position of co-guarantors. Interestingly, while the mental element (subjective intent) of the guarantor plays a role when determining the availability of the defence, the law does not establish a similar element on the counterparty's (i.e. outsider lender's) side.[41]

To sum up, group guarantees raise particular difficulties for transaction avoidance rules. This is because the law requires the assessment of the present value of a contingent right conferred on the creditor by the guarantee and its relation to the benefit received by the guarantor from the advance made to the principal debtor. In practice, various factors can impact this fact-intensive investigation and influence the value of the guarantee to the creditor and guarantor. These factors may include group considerations, such as the recovery of the group and the risks that may arise from group destabilisation.

English law provides for the defence of good faith, propriety of purpose and reasonableness, which might alter the outcome and "save" an otherwise undervalued transaction. That being said, it is generally true that the higher the risk of default by the principal obligor is (e.g. due to financial distress or insolvency), the more likely it is that the guarantee will fall under close scrutiny. This concerns both the assessment of the guarantee's value and the use of the defence.

8.2.3 The USA: in search for future and indirect benefits

When it comes to US law, the relevant provisions concern the remedy for fraudulent transfers. As explained in Collier on Bankruptcy, fraudulent transfer law allows "to avoid transactions which unfairly or improperly deplete a debtor's assets or that unfairly or improperly dilute the claims against those assets."[42]

The US Bankruptcy Code permits a trustee[43] to challenge (avoid) any transfer of an interest of the debtor in property, or any obligation incurred by the debtor, that was made or incurred on or within two years before the date of the bankruptcy filing. A transfer made or an obligation incurred prior to

41 G. McCormack, National Report for the UK, in R. Bork, M. Veder, Harmonisation of Transaction Avoidance Laws, Intersentia, 2022, p. 1294.

42 Collier on Bankruptcy, 16th edn, 2022, Vol. 5, ¶ 548.01.

43 Note that § 548 vests the power to avoid fraudulent transfers in the bankruptcy trustee, but in Chapter 11, § 1107 expands the definition of a "trustee" to include a debtor in possession.

the beginning of the statutory look-back period is invulnerable to an attack as fraudulent. A look-back period may, however, be longer if the action is brought using state fraudulent transfer law.[44] Notably, a transfer or obligation incurred after the bankruptcy filing cannot be considered a fraudulent transfer. But if it is "unauthorised", it may still be subject to avoidance.[45] We will not deal with the category of unauthorised transfers, as many intra-group transactions, including cross-guarantees, are entered into pre-petition and thus fall under the rules on fraudulent transfers.

A transaction may be challenged if the debtor (i) made a transfer or incurred liability with the actual intent to hinder, delay, or defraud creditors ("actual" fraudulent transfers),[46] or (ii) received less than a reasonable equivalent value in exchange for such a transfer or obligation ("constructive" fraudulent transfers).[47]

The first fraudulent conveyance statutes permitted the reversal of transactions only if the ill intent of the debtor was proven. Yet finding such intent could be difficult if the debtor does not cooperate and the transaction has a legitimate business purpose unrelated to injuring creditors.[48] Usually, intercompany guarantees are legitimate business transactions that are not made to defraud creditors. In contrast, the application of "constructive" fraudulent transfer rules is not premised on showing the debtor's intent to harm creditors' interests. Instead, it requires some extra pre-requisites or "plus" factors that make a transaction suspicious and typically signal an increased likelihood of harm. They include, inter alia, the debtor's insolvency at the time of the transaction, the debtor becoming insolvent as a result of the transfer or assumption of an obligation, or the debtor incurring debts beyond its ability to pay as they mature.[49] If the guarantor is insolvent

---

44 The law allows the trustee to avoid any transfer of an interest of the debtor in property or any obligation incurred by the debtor that would otherwise be available to debtor's creditors under state law. 11 U.S. Code § 544(b). Many US states enacted a version of the Uniform Fraudulent Transfers Act, or its slightly modified successor, the Uniform Voidable Transactions Act.

45 11 U.S. Code § 549(a). Filing a bankruptcy petition transforms all debtor's property into property of the estate (11 U.S. Code § 541(a)(1)). From that moment, transfers of the debtor's property are prohibited, unless they fall within a statutory exception, such as transfers authorised under the Bankruptcy Code (e.g. transfers in the ordinary course of business) or by the court.

46 11 U.S. Code § 548(a)(1)(A).

47 11 U.S. Code § 548(a)(1)(B)(i).

48 A prima facie case of fraudulent intent can be established by offering proof of various badges of fraud. These badges include, among others, "(1) a close relationship among the parties to the transaction; (2) secret and hasty transfer not in the usual course of business; (3) inadequacy of consideration; (4) transferor's knowledge of the creditor's claim and the transferor's inability to pay it; (5) use of dummies or fictitious parties; and (6) retention of control of property by the transferor after the conveyance." *Rosener v. Majestic Mgmt. (In re OODC, LLC)*, 321 B.R. 128, 140 (Bankr. D. Del. 2005).

49 11 U.S. Code § 548(a)(1)(B)(ii).

when providing a guarantee, or becomes insolvent as a result of it, or is left with unreasonably small capital, therefore making insolvency highly likely, the guarantee is vulnerable to a fraudulent transfer attack.

The rules on constructively fraudulent transfers are often used to challenge intra-group support transactions. The purpose of voiding transfers unsupported by "reasonably equivalent value" is to protect creditors against the depletion of the debtor's estate.[50] As Clark pointed out, "be just before you are generous."[51] When deciding on what constitutes "reasonably equivalent value", a definition of "value" given in the US Bankruptcy Code is relevant. According to this definition, "value" means "property, or satisfaction or securing of a present or antecedent debt of the debtor […]."[52] The application of this definition to cross-guarantees is problematic, as in most cases, a guarantor does not receive any payment as consideration. As a general rule, obligations incurred by the debtor (guarantor) solely for the benefit of a third party (borrower) are treated as not supported by reasonably equivalent value.[53] However, in recognition of the group reality and contemporary financial practices, in several cases courts departed from an earlier, stricter approach to the value determination, and acknowledged that future or indirect benefits might be accepted.[54] Collier on Bankruptcy identifies three circumstances when an indirect benefit was recognised (not specifically or solely in the guarantee context):

> (i) the debtor and the third party are closely related or share an identity of interests, so that what benefits one will benefit the other on something close to a dollar-for-dollar basis; or (ii) the debtor had the actual use and benefit of the goods or services for which the third party was obligated, again on something close to a dollar-for-dollar basis; or (iii) when the transfer also satisfied an obligation for which the debtor was liable.[55]

---

50 *In re Rodriguez*, 895 F.2d 725, 727 (11th Cir. 1990).

51 R.C. Clark, The Duties of the Corporate Debtor to its Creditors, Harvard Law Review, Vol. 90, 1977, p. 510.

52 11 U.S. Code § 548(d)(2)(A). Note that whereas "value" is defined, "reasonably equivalent value" is not. For example, the Third Circuit described it as follows: "The touchstone is whether the transaction conferred realizable commercial value on the debtor reasonably equivalent to the commercial value of the assets transferred. Thus, when the debtor is a going concern and its realizable going concern after the transaction is equal to or exceeds its going concern value before the transaction, reasonably equivalent value has been received." *Mellon Bank, N.A. v. Metro Communications, Inc.*, 945 F.2d 635, 647 (3rd Cir. 1991).

53 *Tourtellot v. Huntington Nat'l Bank (In re Renegade Holdings, Inc.)*, 457 B.R. 441, 444 (Bankr. M.D.N.C. 2011); *Rubin v. Mfrs. Hanover Trust Co.*, 661 F.2d 979, 991 (2d Cir. 1981).

54 *Rubin v. Manufacturers Hanover Trust Co*, 661 F2d 979, 991 (2d Cir. 1981), holding that "the transaction's benefit to the debtor need not be direct; it may come indirectly through benefit to a third person." *In re Image Worldwide, Ltd.*, 139 F.3d 574, 578 (7th Cir. 1998), noting that "[i]ntercorporate guarantees are routine business practice, and their potential voidability creates a risk for unwary lenders."

55 Collier on Bankruptcy, 16th edn, 2022, Vol. 5, ¶ 548.05[2][b].

The intercompany guarantee and, more generally, group financing relations could fall under these circumstances. For example, in *Mellon Bank*, the court found the reasonably equivalent value for the debtor's guarantee of an affiliate's debt when the loan strengthened the corporate group as a whole, so that the guarantor would benefit from the synergy within the group.[56] In *In re Young*, the court explained that the correct way to determine value was not to define it "only in terms of tangible property or marketable financial value," but instead to "examine […] all aspects of the transaction and carefully measure […] the value of all benefits and burdens to the debtor, direct or indirect, including 'indirect economic benefits.'"[57] In *Telefest Inc.*, it was first stressed that requiring a direct flow of capital to a guarantor to avoid a finding of a fraudulent transfer "is inhibitory of contemporary financing practices, which recognise that cross-guarantees are often needed because of the unequal abilities of interrelated corporate entities to collateralise loans."[58] The court then indicated that indirect benefits to a guarantor can exist when "the transaction of which the guaranty is a part may safeguard an important source of supply, or an important customer for the guarantor."[59] It suggested that "substantial indirect benefits may result from the general relationship between the parent company and its subsidiaries, rather than the particular transaction giving rise to the guaranty."[60] In *Fairchild*, the cross-stream financing was insulated from transaction avoidance, as the companies – the debtor-aircraft manufacturer and the debtor's affiliate, a commuter airline – shared the identity of interest and the debtor benefitted from the continued operation of the airline.[61]

It is important to keep in mind that while cross-guarantees may enhance the overall value of the enterprise group, including the guarantor, they can also merely shift the risk from one group entity to another or support the resurrection gamble, particularly if no viable enterprise exists. In the case concerning the insolvency of TOUSA Inc. and its subsidiaries, formerly one of the largest homebuilding enterprises in the USA, it was concluded that the argument of bankruptcy prevention (survival of the group) that may be cited to prove the benefit for the subsidiaries-lien providers arising from financing acquired by their borrower-parent was not persuasive.

---

56 *Mellon Bank, N.A. v. Metro Communications, Inc.*, 945 F.2d 635, 647 (3rd Cir. 1991). The court pointed out that indirect benefits included intangibles such as goodwill and an increased ability to borrow working capital.

57 *United States v. Crystal Evangelical Free Church (In re Young)*, 82 F.3d 1407, 1415 (8th Cir.1996), vacated on other grounds.

58 *Telefest, Inc. v. VU-TV, Inc.*, 591 F.Supp. 1368, 1379 (D.C.N.J.,1984).

59 Ibid., at 1381.

60 Ibid. See also *In re Tryit Enterprises*, 121 B.R. 217 (Bankr. S.D. Tex. 1990), refusing to annul cross-guarantees on the basis that they were necessary for the optimal (group) financing arrangement.

61 *Matter of Fairchild Aircraft Corp.*, 6 F.3d 1119, 1126 (C.A.5 (Tex.),1993).

The bankruptcy court observed that "not every transfer that decreases the odds of bankruptcy for a corporation can be justified."[62] It did not decide whether a chance to avoid bankruptcy can in principle constitute "reasonably equivalent value." Instead, it found that in the case at hand, financing secured by the subsidiaries' liens only delayed the inevitable collapse, as "[i]n contrast to the surprise attack at Pearl Harbor, the warnings about the collapse of TOUSA [debtor] made that event as foreseeable as the bombing of Nagasaki after President Truman's ultimatum."[63] Notably, the court in the first instance, whose judgment was affirmed on appeal, examined the group characteristics. It noted that the insolvency of the parent company would not necessarily have caused the subsidiaries to declare bankruptcy, and that the subsidiaries could have operated as independent entities without the services provided by the parent.[64]

TOUSA brings into focus the fraudulent transfer risk in financial arrangements within complex corporate families, especially where the borrower and the affiliated guarantors are financially distressed or when their insolvency is foreseeable at the time of the transaction. It also shows that the avoidance risk increases if the borrower is non-viable, and if the guarantor can function independently from its group affiliates.

As mentioned in the previous section, the analysis of benefits stemming from a corporate guarantee or its reasonable equivalent value may differ in situations where the guarantee is provided by the corporate parent (downstream guarantee). In the USA, courts tend to presume that the parent corporation receives a benefit in the form of increased stock value flowing from the increased strength and value of its subsidiary when the subsidiary obtains a loan guaranteed by the parent.[65] Therefore, downstream guaran-

62 *In re Tousa*, 680 F.3d 1298, 1311 (11th Cir. 2012).

63 Ibid., at 1313.

64 *In re Tousa, Inc.*, 422 B.R. 783, 847 (Bankr. S.D.Fla. 2009).

65 *In re Royal Crown Bottlers of N. Am., Inc.*, 23. B.R. 28, 30 (Bankr. N.D. Ala. 1982), stating that "the passing to a subsidiary of the consideration for a transfer by a debtor-parent may be presumed to be substantial […]."; *Branch v. Fed. Deposit Ins. Corp.*, 825 F.Supp. 384, 400 (D. Mass. 1993), noting that the "Court is aware of no case in which transfers to a solvent subsidiary have been determined to be for less than equivalent value." P. Blumberg, Intragroup (Upstream, Cross-Stream, and Downstream) Guarantees under the Uniform Fraudulent Transfer Act, Cardozo Law Review, Vol. 9, 1987, p. 701, explaining that in case of a downstream guarantee "additional liability incurred by the parent is offset by a comparable increase in the value of its equity interest." R.K. Rasmussen, Guarantees and Section 548(a)(2) of the Bankruptcy Code, The University of Chicago Law Review, Vol. 52, 1985, p. 215, arguing that when a debtor guarantees the obligations of its wholly owned subsidiary, "there should be a rebuttable presumption that the debtor received a reasonably equivalent value through indirect benefits."

tees are largely immune to attacks under fraudulent transfer rules.[66] Some courts have recognized this important point and noted that the otherwise applicable presumption of indirect benefits arising from a downstream guarantee does not apply if the subsidiary, whose obligation is guaranteed by the parent, is insolvent at the time of the transaction in which the guarantee is extended.[67]

In summary, the position of the US Bankruptcy Code on the avoidance of intra-group guarantees has some similarities to that of the Insolvency Act 1986. Both require a fact intensive analysis of the benefits (value) of the transaction at the time of its conclusion. Notably, in such an analysis, future and indirect benefits, including those arising from the relations and synergies with the principal debtor or those stemming from group operations, can be taken into account. This is likely to be the case in closely integrated and interdependent groups of companies.[68] As in the UK, it is also true that defending an intra-group transfer (e.g. in the form of a guarantee, collateral or provision of capital) is more difficult if, at the time of such a transfer, the guarantor and/or the principal debtor were insolvent or near insolvent. The type of the guarantee (downstream, upstream, or cross-stream) is equally important. Downstream guarantees are usually safe from fraudulent transfer challenges. Yet even they may become vulnerable to avoidance as constructively fraudulent transfers if the subsidiary-borrower was insolvent at the time when the parent company extended a guarantee. As for the differences, whereas the UK approach looks at whether there is a significant imbalance between the benefits (value) of the guarantee to the creditor and the value generated by the loan to the guarantor, the US approach mainly focuses on the benefits to the guarantor, whether direct or indirect. In prac-

66 *Branch v. Fed. Deposit Ins. Corp.*, 825 F.Supp. 384, 389 (D. Mass. 1993) ("Generally, transfers to a solvent subsidiary are considered to be for reasonably equivalent value, because, since the parent is the sole shareholder of the subsidiary corporation, any benefit received by the subsidiary is also a benefit to the parent."). See, however, R. Squire, Distress-triggered liabilities and the agency costs of debt, in B.E. Adler (ed), Research Handbook on Corporate Bankruptcy Law, Edward Elgar Publishing, 2020, p. 137, stating that "a downstream guarantee – despite being the variety least vulnerable to fraudulent-transfer attack – typically produces a larger distortive transfer than an otherwise equivalent cross-stream guarantee, as the parent's equity stake in the subsidiary increases the correlation between the two entities' insolvency risks."

67 *In re Renegade Holdings*, Inc., 457 B.R. 441, 445 (Bankr. M.D.N.C., 2011), at 446 also noting that "the totality of the circumstances to be considered in assessing and weighing value versus obligation in this case includes the insolvency […] and whether the enterprise involving the Debtors and PTM [subsidiary-borrower] was *commercially viable*." (emphasis added). Also, *In re Duque Rodriguez*, 77 B.R. 937, 939 (Bankr. S.D.Fla. 1987).

68 Greer et al. argue (and we concur) that where "the parties involved are genuinely interdependent in some form or where the guaranty will enable the guarantor and affiliate for which it has provided a guaranty to realize genuinely synergistic gains […], the courts should protect the transfer, notwithstanding the fact that the estate may have been somewhat diminished by the transaction." B.E. Greer, J.S. Moss, N.B. Herther-Spiro, Guarantees in Bankruptcy: A Primer II, Norton Annual Survey of Bankruptcy Law, 2014 edn, p. 209.

tice, the effects of this difference may not be substantial, as both values tend to be correlated.

8.2.4 The Netherlands: *Faillissementspauliana*

The Dutch Bankruptcy Act provides for insolvency-related transaction avoidance rules (*actio pauliana*) in Articles 42-51. There are two principal sets of rules.[69] One of them, namely Article 42 Fw, regulates the avoidance (annulment) of legal acts, which the debtor had no prior obligation to perform. A legal act is considered obligatory if the debtor is legally obliged to perform it or, in other words, when a prior enforceable legal obligation existed for the debtor to perform the legal act in question.[70] If such a legal obligation exists, a legal act can only be challenged on the basis of Article 47 Fw, and not Article 42 Fw. The requirements for avoidance of obligatory legal acts are understandably more demanding compared to non-mandatory ones. In this section, we will first address avoidance under Article 47 Fw and then proceed with the rule of Article 42 Fw.

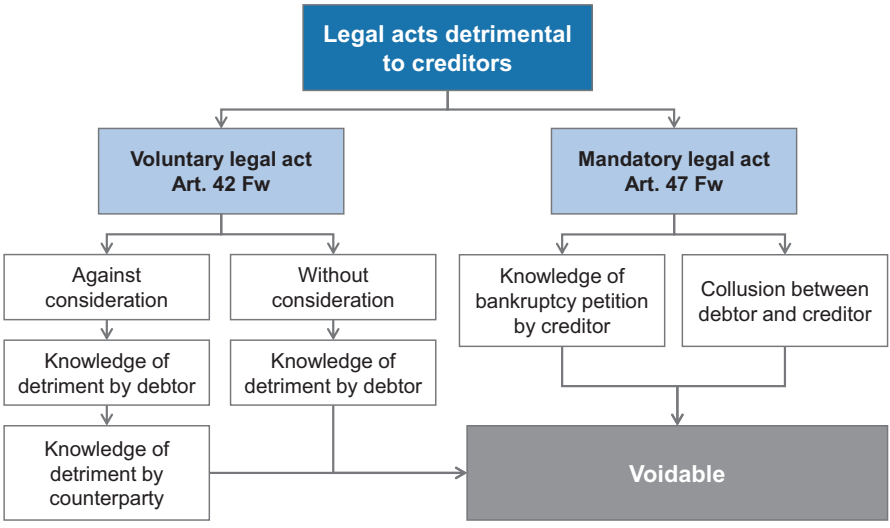

Figure 6. Transaction avoidance in Dutch insolvency law[71]

69 On both sets of rules, see B. Wessels, Gevolgen van faillietverklaring (Wessels Insolventierecht nr. III), 5e druk, Deventer: Wolters Kluwer, 2019, par. 3017-3273.

70 R.J. de Weijs, D.G.J. Heems, GS Faillissementswet, commentaar op art. 42 Fw; R.D. Vriesendorp, Insolventierecht, Deventer: Wolters Kluwer 2021.

71 This figure is based on N.B. Pannevis, The European harmonisation of avoidance rules, a Dutch perspective on reshaping an age-old instrument, TvI 2023/12, p. 78.

A guarantee may be considered an obligatory legal act if the guarantor undertook to extend a guarantee to a creditor prior to the actual granting of the guarantee, e.g. when the advance was made to the borrower on the condition that the guarantee would be granted in the future.[72] According to Article 47 Fw, the performance of a due and demandable (payable) obligation (*opeisbare schuld*) can be annulled only on the ground of fraudulent conveyance if it is shown that either the other party was aware of a pending bankruptcy petition, or the performance is the result of consultations (*overleg*) between the debtor and the creditor with the intention to favour that creditor. According to the Dutch Supreme Court, the second criterion requires collusion.[73] Notably, unlike Article 42 Fw (see further below), Article 47 Fw does not distinguish between gratuitous legal acts and legal acts for consideration.

As noted in the previous paragraph, for a successful challenge under Article 47 Fw, a creditor should be aware of the bankruptcy petition, or there has to be collusion between the creditor and the debtor. These elements must be restrictively interpreted. Regarding the creditor's awareness, it is not sufficient for the creditor to have knowledge of the likely or inevitable insolvency.[74] Instead, it needs to be shown that the creditor had knowledge of the filed bankruptcy petition. This rule is easy to apply in practice, which, according to the legislator's intent, should facilitate certainty of transactions. Unless the creditor and the guarantor have the same directors or a creditor was specifically notified about the bankruptcy filing, it will be difficult to demonstrate that the creditor was aware of the filed bankruptcy petition.

Proving collusion is even more challenging, as it requires more than just knowledge of disadvantage.[75] Dutch courts set a high bar to show the actual intention of the debtor and its creditor to favour the latter.[76] In *Cikam/Siemon qq*, the Dutch Supreme Court upheld the judgment of the Court of

72 R.J. de Weijs, D.G.J. Heems, GS Faillissementswet, commentaar op art. 42 Fw, observing that a broad interpretation should be given to what may constitute an obligatory legal act, and that it may encompass the creation of a security right. See HR 1 February 2013, *JOR* 2013/155, *NJ* 2013/156 (*Van Leuveren q.q./ING*), dealing with silent pledging of future claims by means of a collective deed construction (*verzamelpandakteconstructie*). Yet, if the prior legal obligation exists, the creation of such a prior legal obligation may itself be challenged under Article 42 Fw.

73 HR 24 March 1995, *NJ* 1995/628 (*Gispen q.q./IFN*).

74 HR 29 June 2001, *JOR* 2001/220, *NJ* 2001/662 (*Meijs qq/Bank of Tokyo*).

75 HR 20 November 1998, *NJ* 1999/611 (*Verkerk Varkenshandel/Tiethoff q.q.*).

76 HR 24 March 1995, *NJ* 1995/628, m.nt. P. van Schilfgaarde (*Gispen q.q./IFN*). R.D. Vriesendorp, Art. 47 FW: een geamputeerde tentakel of verdient de curator meer? in S.C.J.J. Kortmann e.a. (red.), De curator, een octopus, Zwolle: W.E.J. Tjeenk Willink 1996, p. 65-79; R.D. Vriesendorp, Enkele grenzen van artikel 47 Fw verkend: een machtig wapen voor de curator of een dode letter, Insolad Jaarboek 2014, Deventer: Kluwer 2015, p. 165-193.

Appeal, which assumed collusion, subject to proof to the contrary, on the basis of a very close connection between the creditor and the debtor with the same officers, and knowledge of both parties of the debtor's financial distress.[77] Conversely, if the guaranteed creditor is not related to the debtor, showcasing collusion is difficult.

In practice, it is likely that an IP will challenge the guarantee under Article 42 Fw, which applies to voluntary (non-obligatory) legal acts. After all, intercompany guarantees are usually provided without a prior obligation to grant them. The use of the parent company's power of instruction over the subsidiary-guarantor, whether legal or economic, does not make the guarantee an obligatory legal act.[78]

Article 42 Fw stipulates that if the debtor, prior to the commencement of the bankruptcy proceedings, performed a legal act which he was not obliged to perform, while he knew or should have known that the recovery rights of his creditors would be harmed as a result, this legal act (*rechtshandeling*) is voidable on the ground of fraudulent conveyance and may be nullified on the application of an insolvency practitioner. This provision aims to protect creditors from legal acts that prejudice them in insolvency. It targets (1) actions that reduce creditors' recovery capacity and damage both the debtor and creditors. Examples include a sale of the debtor's property below market value or the assumption of new debts without equivalent return (undervalued transaction). It also applies to (2) actions that are neutral to the debtor itself but interfere with the *pari passu* principle, such as paying a single creditor in the vicinity of insolvency to the disadvantage of other creditors (preferential transaction).[79]

There are several conditions that must be satisfied for an avoidance action to be successful: (i) optionality (voluntary character) of a legal act – the act is not mandated by law or contract, (ii) prejudice to creditors – broadly interpreted, and (iii) knowledge of the prejudice at the time the legal act was performed. Hence, the mere prejudice is insufficient. It is required that the debtor acted with knowledge of prejudice, that is to say that he knew or should have known that his creditors would be prejudiced in their recovery options as a result of the act.

---

77 HR 7 March 2003, *JOR* 2003/102, *NJ* 2003/429 (*Cikam/Siemon q.q.*).

78 Even if there is economic necessity, perceived or real, to perform a legal act, this does not mean that such legal act is mandatory. HR 10 December 1976, *NJ* 1977/617 (*Eneca/BACM*).

79 B. Wessels, Gevolgen van faillietverklaring (Wessels Insolventierecht nr. III), 5e druk, Deventer: Wolters Kluwer, 2019; R.J. van der Weijden, De faillissementspauliana (Onderneming en recht nr. 75) (diss. Nijmegen), Deventer: Kluwer 2012, p. 68-77.

Relevant to the element of knowledge, Dutch law distinguishes between gratuitous legal acts and legal acts concluded for consideration. In the case of the former, only the debtor's knowledge is relevant. It is presumed that such knowledge exists if the legal act was performed within one year before the declaration of bankruptcy.[80] In *Van Doorn Beheer/Thielen q.q.*, the court ruled that a guarantee granted by the subsidiary to finance the purchase of its shares from the parent company was an act for no consideration.[81] Also, if a security right (personal or *in rem*) is granted for a loan that has already been extended – without such security right being a precondition for the loan – the provision of the security might be regarded as a gratuitous legal act, unless there is some form of consideration (e.g. deferral on loan repayment, interest rate reduction, continued financing under a revolving credit facility).[82] If the guarantor derives some benefit from financing of another party, including obtaining direct or indirect access to credit, the guarantee does not constitute a gratuitous legal act.[83]

To annul a legal act made for consideration, knowledge of the prejudice by both the debtor and its counterparty is required. This should not be confused with the intention to cause harm or disadvantage, as showing such intention is not necessary. It is also not necessary for the parties to foresee the extent of the disadvantage or identify the injured parties.[84] To prove the required knowledge, an IP needs to show that at the time of the legal act, insolvency and a deficit could have been foreseen with a reasonable degree of probability by both the debtor and the party with or towards whom the debtor performed the legal act.[85] Thus, if the financier is or should be aware of the guarantor's financial distress and likely insolvency, the knowledge of the disadvantage may be attributed to it.

80 Dutch Bankruptcy Act, Article 45.

81 Gerechtshof Arnhem-Leeuwarden 12 February 2013, ECLI:NL:GHARL:2013:822, *JOR* 2014/78; Gerechtshof Arnhem-Leeuwarden, 12 September 2017, ECLI:NL:GHARL:2017:8021, finding that the payment made by the subsidiary to a lawyer of its parent company was an act for no consideration.

82 R.J. de Weijs, Faillissementspauliana, Insolvenzanfechtung en Transaction Avoidance in Insolvencies. Naar een geobjectiveerde regeling van schuldeisersbenadeling (Recht en Praktijk nr. InsR1) (diss. Amsterdam UvA), Deventer: Kluwer 2010, 4.2.1.2.3.

83 A. Jonkers, Selective Perforation by Means of Guarantees: Dutch Law, in The 800-Pound Gorilla. Limits to Group Structures and Asset Partitioning in Insolvency, NACIIL 2018 report, Eleven International Publishing, 2019, p. 79, noting that "even guarantees for which no direct premium is paid will usually be viewed as "for consideration".

84 R.J. de Weijs, D.G.J. Heems, GS Faillissementswet, commentaar op art. 42 Fw.

85 HR 22 December 2009, *NJ* 2010/273 *(ABN/Van Dooren q.q. III*). Read further R.J. van der Weijden, Wetenschap van benadeling in de zin van art. 42 Fw en de voorzienbaarheid van het faillissement van de schuldenaar, MvV, afl. 10, 2017, p. 285-289.

In practice, proving knowledge is difficult.[86] For this reason, Article 43 Fw establishes a number of presumptions. These presumptions apply to non-mandatory legal acts that took place within one year before the bankruptcy order was made. They cover instances which indicate the suspicious nature of a legal act, either because of the nature of the act itself (e.g. if the performance by the debtor was not yet due, *niet-opeisbare schuld*) or because of the persons involved.[87] For example, knowledge of the prejudice is presumed if the transaction involves another company within the same enterprise group.[88] In case of a guarantee, however, a creditor is often a non-related party (outside lender). This makes the presumption inapplicable Yet if the financier is a group member, the presumption will apply.

For the purposes of this section, another presumption is relevant. Under it, the knowledge of prejudice exists if the value of an obligation on the part of the debtor *significantly* exceeds that of the obligation on the other side.[89] An example of this can be an agreement where the debtor sells an asset for a fraction of its market value or pays substantially more when buying an asset.[90] A manifest discrepancy in the price indicates that the legal act is suspicious. Another example relates to a situation where the debtor accepts joint and several liability for the fault of another person without receiving any benefit.[91] As observed in the previous sections, the calculation of the value or benefits related to intra-group transactions, such as cross-guarantees, is very complex. Ultimately, a court has to assess the upside to the guarantor and determine whether this upside is proportionate to the liability incurred. If the guarantor has not benefited from the advance made to the borrower, the transaction is considered to be at an undervalue.

Dutch courts recognise the realities of enterprise groups and group interest as legally relevant factors, although in different contexts. For example, they have confirmed the existence of a "duty of group management" (*concernleidingsplicht*) of a parent company in an integrated enterprise group, which encompasses an obligation to actively oversee subsidiaries in order to prevent insolvency or minimise losses.[92] A parent company may therefore be liable in tort (6:162 BW) where the group structure has been set up with inherent risks for creditors of a subsidiary, and where the parent company discontinues financial support to a subsidiary, while its appearance of cred-

86 G. van Dijck, De Faillissementspauliana: Revisie van een Relict (proefschrift), 2016, p. 84, noting that 75% of the surveyed IPs indicated that it was (very) difficult to demonstrate knowledge of prejudice in situations where no presumption applied.

87 G.F. van der Feltz, Geschiedenis van de Wet op het Faillissement en de Surséance van Betaling, Haarlem: De Erven F. Bohn 1896, p. 442-443.

88 Dutch Bankruptcy Act, Article 43(1)(6).

89 Dutch Bankruptcy Act, Article 43(1)(1).

90 R.J. van der Weijden, De Faillissementspauliana, Deventer: Kluwer, 2012, p. 143.

91 F.M.J. Verstijlen, in: *T&C Insolventierecht*, commentaar op art. 42.

92 HR 21 December 2001, *NJ* 2005/96 (*Sobi/Hurks*).

itworthiness misguides creditors.[93] Directors of the subsidiary could take into account group interest, but this interest does not take precedence over the subsidiary's own interests.[94]

Thus, when reviewing intra-group financial transactions, various group-related circumstances may be taken into account. A court will consider which entity used the loan (e.g. whether the guarantor had access to the funds) and other relevant facts.[95] Focusing on a single transaction may not capture the whole picture. The availability of credit, improved through the issuance of a guarantee, might create wider benefits. These benefits may arise, for instance, if through outside financial injections it is possible to invest in other parts of the group to expand certain profit-making activities or keep other parts of the group, including the guarantor, viable.[96] Dutch law recognises that a legal act that in itself leads to the prejudice of creditors but which is part of a set of legal acts (*samenstel van rechtshandelingen*) that does not result in any prejudice cannot be annulled. This rule is deduced from the rationale of *faillissementspauliana* and is confirmed by the case law of the Dutch Supreme Court.[97] The "disadvantage" of the contested legal act can therefore, under certain (rather limited) circumstances, be mitigated or offset by the "advantage" (*gunstige gevolgen*) that lies outside the contested legal act.[98] This advantage should be conferred on creditors of the debtor (guarantor), and not solely on another group member (principal debtor-borrower) and its creditors.[99]

In sum, intra-group guarantees may be subject to avoidance actions (*actio pauliana*) pursuant to the Dutch Bankruptcy Act. For a non-Dutch lawyer, the law can look like a labyrinth. Different rules apply, depending on whether the guarantee constitutes the performance of a due and enforceable (payable) obligation or whether it was granted without prior commitment.

---

93 HR 11 September 2009, *NJ* 2009/565, *JOR* 2009/309 (*Comsys/Van den End q.q.*).

94 HR 26 October 2001, *NJ* 2002/94 (*Juno*). S. Bartman, Dutch Supreme Court at a Loss over Groups, European Company Law, Vol. 13, 2016, p. 125. See also HR 7 July 2017, *NJ* 2018/363 (*Oi Brasil Holdings Coöperatief/Citadel e.a.*) and *NJ* 2018/364, m.nt. F.M.J. Verstijlen *(Portugal Telecom International Finance/Citicorp Trustee Company e.a.*). The court noted with respect to Article 242 Fw (withdrawal of suspension of payments), that an IP may take into account the interests of the group in his decision. Yet the court pointed out that in bankruptcy proceedings, the starting point was the separate legal personality of group entities.

95 HR 13 July 2012, *JOR* 2012/306 (*Janssen q.q./JVS*).

96 HR 8 April 2003, *JOR* 2003/160 (*Rivier de Lek/Van de Wetering*), dealing with an internal obligation to contribute in group relationships.

97 HR 10 December 1976, *Nl* 1977/617 (*Curatoren Eneca/BACM*); HR 22 March 1991, *NJ* 1992/214, m.nt. Van Schilfgaarde (*Loeffen q.q./Mees & Hope II*); HR 9 June 2006, *NJ* 2007/21, m.nt. Van Schilfgaarde (*Smit/Van Hees q.q.*); HR 19 December 2008, *NJ* 2009/220 (*Curatoren AHC/Air Holland c.s.*).

98 R.J. van der Weijden, De faillissementspauliana, Deventer: Kluwer, 2012, 5.5.1.

99 Ibid.

For the category of non-obligatory legal acts – which most guarantees are likely to fall within – unless the transaction is gratuitous, the trustee must prove, among other things, the detriment and knowledge of both parties to such a transaction of its prejudicial character to the guarantor's creditors. This this hard to do. It must be shown that the guarantee was extended at the time when the financier could have anticipated the guarantor's insolvency with a reasonable degree of probability. Therefore, it is difficult to annul intercompany guarantees granted more than a year before the opening of the insolvency proceedings. As for transactions concluded within a one-year suspect period, the evidentiary presumption of knowledge applies if the transaction is undervalued. As it was illustrated in the English and US law sections, determining the value of a group guarantee and showing that it is not substantially lower than the assumed obligation is problematic. Dutch courts may have regard to the group reality and recognise indirect benefits for the guarantor. The extent of this recognition is not clear and will depends on the totality of facts. In examining these facts, courts could hypothesise what would have been the outcome if the guarantee had not been granted.[100] This contextual backward-looking analysis contributes to legal uncertainty and makes intercompany guarantees especially vulnerable to avoidance actions.

8.3 Difficulties of Ex Post Substantive Review

The insolvency law frameworks of the UK, the USA and the Netherlands contain rules that can be relied upon to challenge intra-group financial transactions, including cross-guarantees. Despite important differences and nuances (e.g. length of the suspect periods, requirements concerning knowledge of a counterparty, presumptions, defences), there are similarities. For example, in all three jurisdictions, a cross-guarantee may be subject to transaction avoidance as a transaction at an undervalue. Undervalued transactions are harmful to creditors because they reduce the insolvency estate value, otherwise available to creditors. The determination of whether an intercompany guarantee is such a transaction requires a fact-sensitive analysis. This analysis may include the assessment of:

- Direct and indirect benefits for a guarantor;
- Financial positions of the guarantor and principal debtor at the time of the transaction;

100 HR 19 October 2001, *NJ* 2001/654, *JOR* 2001/269, m.nt. NEDF *(Diepstraten q.q./Gilhuis)*; Parket bij de HR, 16 October 2020, 19/05439, Conclusie B.F. Assink (*Volkerink q.q./Rabobank*), r.o. 3.17, arguing that what is required is "although not always simple – a realistic, measurable assessment of what concretely would have happened if that legal act had not taken place, making the judgment of probability intrinsically contextual."

- Degree of legal and economic integration within the group;
- Type of the guarantee: upstream, downstream or cross-stream.

With a certain, inevitable degree of generalisation, it can be observed that: (i) the vaguer and more distant the benefit of the guarantee is for the guarantor, (ii) the less stable the financial position of the guarantor and/or of the principal debtor is at the time of the transaction, (iii) the less integrated the group is – making continued existence of the guarantor less dependent on that of the principal debtor or other group entities, and (iv) if the guarantee is an upstream or cross-stream guarantee, the more vulnerable the guarantee becomes to an avoidance action.

Ex post (judicial) review of debtor's transactions is indispensable for the protection of creditors' rights.[101] Transaction avoidance rules contribute to the achievement of the principles of estate value maximisation and equal treatment of creditors. Additionally, an insolvency transaction avoidance procedure might also allow creditor participation or even initiation,[102] encouraging creditors to play an active role and ensuring *procedural fairness*. That said, there are important downsides and difficulties related to an ex post substantive review, especially when applicable to intra-group financing.

First, when applying rules on avoidance of undervalued transactions, determining reasonably equivalent value is often problematic.[103] This is especially true for intercompany guarantees – transactions for which no

101 A. Keay, The Harmonization of the Avoidance Rules in European Union Insolvencies, International & Comparative Law Quarterly, Vol. 66, 2016, p. 84, observing that the avoidance provisions promote collectivism and fairness among creditors, and protect them from unfair diminution of the insolvency estate.

102 An example of the law that allows creditors to initiate insolvency *pauliana* actions is Article 61.9(2) of the Russian Bankruptcy Act. In the jurisdictions studied in this book, creditors' right to challenge debtor's transactions is limited. See e.g. Article 49 Fw, according to which only an IP is authorised to challenge legal acts under Articles 42 and 47 Fw. However, creditors can compel an IP to challenge a legal act pursuant to Article 69 Fw. In the UK, with respect to transactions at an undervalue and preferences, only an IP (liquidator, administrator) has standing (sec. 238 and 239 Insolvency Act 1986). Yet transactions defrauding creditors can be challenged by any "victim" of a transaction, which includes creditors (sec. 424, providing that in insolvency proceedings, a victim can apply for an order only with the leave of the court). The US law gives a bankruptcy trustee or a DIP the sole authority to pursue fraudulent transfer actions (11 U.S. Code § 548). However, courts have allowed creditors' committees or individual creditors to commence litigation on behalf of the estate (derivative standing) under narrowly defined circumstances, e.g. where a DIP or a trustee unjustifiably refused either to pursue the claim or to consent to the movant's prosecution of the claim on behalf of the estate. *Official Comm. of Unsecured Creditors v. Meltzer*, 589 B.R. 6, 16 (D. Me. 2018); *In re Know Weigh, L.L.C.*, 576 B.R. 189, 210 (Bankr. C.D. Cal. 2017).

103 D.G. Baird, Legal Approaches to Restricting Distributions to Shareholders: The Role of Fraudulent Transfer Law, EBOR, Vol. 7, 2006, p. 211, noting that "[v]aluations by their nature are uncertain."

relevant market benchmark exists. Courts have to assess the true economic value of a transaction, which may entail an inquiry into complex business structures and group interdependencies. This is because, in most instances, a group entity acting as a guarantor does not receive a direct benefit for providing the guarantee but may derive indirect group-related benefits. Courts may be required to consider, with the benefit of hindsight, what would have happened in the alternative scenario, for example, in a hypothetical case where the guarantee had not been provided. Mevorach comments that the need to evaluate the true economic effect of a transaction or a combination of transactions "makes the law potent but also somewhat unpredictable."[104]

Second, transaction avoidance law is often connected to the issue of directors' liability and the decision-making process. After all, it is directors or an appointed chief executive officer (CEO) who decide whether to enter into a transaction. Debtor's management can be found personally liable for permitting the company to make a transaction that is declared void in insolvency.[105] However, especially in the shadow of insolvency, making the "right" choices is very difficult. As aptly spotted by Licht, the "vicinity-of-insolvency duties form a notoriously murky area, where legal space warps. The contours of this area are fuzzy."[106] On the one hand, directors are influenced by cognitive biases, such as self-serving bias, positive outcome or optimism bias, and illusion of control.[107] One the other hand, the irregularity of events of financial distress (compared to the business-as-usual), significant complexity imposed by diversity of interests, including the interests of other group companies, lack of adequate information, and uncertainty about the future, coupled with significant time pressure, make a choice of the "correct" strategy or transaction challenging. Both cognitive biases and irregularity of crisis situations indicate that ex post control may be a less suitable strategy for protecting creditors' rights or guiding directors' behaviour ex ante, at the time of the crisis.

---

104 I. Mevorach, Transaction Avoidance in Bankruptcy of Corporate Groups, ECFR, Vol. 8, 2011, p. 243.

105 UNCITRAL Legislative Guide, Part four, Section two, para. 7.

106 A.N. Licht, My Creditor's Keeper: Escalation of Commitment and Custodial Fiduciary Duties in the Vicinity of Insolvency, Washington University Law Review, Vol. 98, 2021, p. 1732.

107 On cognitive biases in the vicinity-of-insolvency decision-making, see M-W. Hung and W-H. Tsai, Managerial optimism, CEO retention, and corporate performance: evidence from bankruptcy-filing firms, Journal of Economics and Finance, Vol. 44, 2020, p. 506, studying the data on bankruptcy-filing firms in the USA, and concluding that managerial optimism is detrimental to operating performance at filing and survival probability. See also F. Drescher, Insolvency Timing and Managerial Decision-Making, Springer Gabler, 2014, p .84, arguing that the "context factors of the insolvency timing decisions are very likely to aggravate the manager's cognitive limitations."

Third, the effectiveness of the ex post review depends on how sophisticated and experienced the judges are. As demonstrated above, review of intra-group transactions encompasses complex issues related to indirect benefits, knowledge of prejudice, calculation of reasonably equivalent value, and the significance of an imbalance. Judges could have wide discretion when assessing these elements, and such assessment might be time-consuming and costly for the parties involved. The difficulty in evaluating cross-guarantees makes the ex post review less desirable in jurisdictions where the judiciary is less sophisticated and reliable.[108] This problem is exacerbated by the fact that the ex post review is clouded by hindsight and outcome biases, as a transaction is judged with full knowledge of an adverse outcome.[109] Notably, cognitive biases cannot be eliminated even in countries with experienced judges. Although knowledge or awareness about the existence of judgmental heuristics and resulting biases may help avoid certain simple errors, they are unlikely to mitigate the hindsight bias.[110] A combination of biases with the inherent uncertainty and complexity of the ex post evaluation contributes to over-deterrence of intra-group financing.[111]

The lack of predictability in applying transaction avoidance rules to intra-group transactions, such as intercompany guarantees, is problematic for a number of reasons. Legal uncertainty surrounding ex post review is harmful to the principle of protection of legitimate expectations. It can contribute to the increased cost of finance due to the risk of a guarantee being annulled

108 A. Gurrea-Martínez, Towards an optimal model of directors' duties in the zone of insolvency: an economic and comparative approach, Journal of Corporate Law Studies, Vol. 21, 2021, pp. 389-390, arguing that "in jurisdictions without sophisticated and reliable judicial systems […], the discretion of courts should be reduced."

109 N. Strohmaier et al., Hindsight bias and outcome bias in judging directors' liability and the role of free will beliefs, Journal of Applied Social Psychology, Vol. 51, 2020, pp. 141-158, finding that professional legal investigators such as judges and lawyers are affected by hindsight and outcome biases when assessing directors' conduct. A. Gurrea-Martínez, The Avoidance of Pre-Bankruptcy Transactions: An Economic and Comparative Approach, Chicago-Kent Law Review, Vol. 93, 2018, p. 714, observing that "hindsight bias will incentivize creditors, judges, and trustees to think that the transaction potentially challenged was harmful ex ante, even if it, at the moment of entering into the transaction, it looked reasonable."

110 G. Mandel, Patently Non-Obvious: Empirical Demonstration that the Hindsight Bias Renders Patent Decisions Irrational, Ohio State Law Journal, Vol. 67, 2006, pp. 1391-1463; D. Hardman, Judgment and Decision-Making: Psychological Perspectives, BPS Blackwell, 2009, p. 37.

111 A.M. Pacces, Procedural and Substantive Review of Related Party Transactions: The Case for Noncontrolling Shareholder-Dependent Directors, in L. Enriques and T.H. Tröger (eds), The Law and Finance of Related Party Transactions, CUP, 2019, pp. 182-183, commenting with respect to the ex post substantive review of related-party transactions (not specifically in the insolvency context), that "fundamental incompetence of courts to evaluate the efficiency of RPTs stems from the same rationale behind judges' abstention from second-guessing business judgment" and arguing that "substantive ex-post review tends to over-deter RPTs as it leads courts to second-guess, with hindsight bias, the decision to enter into RPTs."

ex post, and result in foregone transactions. This is not bad if these transactions are value-destroying (overinvestment, debt dilution, etc.) and harm the guarantor's pre-existing creditors. However, it is undesirable if it leads to the underinvestment problem, as a result of which value-enhancing transactions and rescue attempts do not occur.

8.4 Conclusion

In the realm of enterprise group insolvency, there are many possibilities but few certainties. This observation also holds true for the rules regulating intra-group financing transactions. The application of these rules is often context specific and is marred by legal uncertainty. Some of it may be attributed to insolvency law itself, referred to by Goode and Gullifer as "one of the most technical and, in some respects, one of the most arbitrary branches of law."[112] To a certain degree, this can also be explained by the complexity of intra-group relations, diversity of operational and financial arrangements within enterprise groups, as well as varying levels of interdependence and integration characterising groups. This chapter explored one area of insolvency law, namely transaction avoidance, a form of an ex post review of debtor's transactions. This review entails the substantive assessment of a transaction under insolvency transaction avoidance rules.

When dealing with transactions involving group entities, UNCITRAL points out that intra-group transactions may need to be "considered differently when viewed in the broader context of an enterprise group, where the benefits and detriments of transactions might be more widely assigned."[113] It has been observed that national legal systems are in principle capable of taking the group context (e.g. group integration and interdependence) into account when reviewing transactions. For example, US courts have, when applying the remedy of fraudulent transfers, looked beyond a single entity and considered whether entities in a group were closely related and shared the "identity of interest". There may be some room for group considerations in English and Dutch transaction avoidance law, even though the full extent of their recognition and impact remains unclear. A common challenge lies in the calculation of indirect benefits stemming from the extension of a cross-guarantee. This calculation is problematic due to the difficulty of determining the (market) value of a guarantee ex post and the uncertainty that such determination creates. It increases the demand for specialised courts experienced in resolving insolvency and valuation disputes.

112 R. Goode, L. Gullifer, Goode and Gullifer on Legal Problems of Credit and Security, 6th edn, Sweet & Maxwell, 2017, para. 8-16.

113 UNCITRAL Legislative Guide, Part three, Ch. II, para. 75.

Based on the analysis of UK, US and Dutch law, the following conclusions are drawn:

- The application of insolvency transaction avoidance rules to intra-group transactions, such as group guarantees, lacks certainty. It involves a fact-intensive analysis in which various considerations may play a role, e.g. existence of co-guarantors (against whom a claim for contribution can be filed) or *in rem* security interest that the guarantor can "inherit" via the right of subrogation. These considerations affect guarantor's risk.
- Any ex post assessment of transactions can be affected by various cognitive biases, which may unjustifiably influence a court's decision. Such cognitive biases cannot be fully eliminated, even if they are acknowledged by decision-makers.
- The vaguer and more distant the value or conferred benefit for the guarantor is, the more vulnerable the guarantee becomes to a future avoidance action.
- A transaction becomes even more vulnerable to transaction avoidance if, at the time of the transaction, either the principal debtor or the guarantor is financially distressed or insolvent, making the risk of harm to their creditors more pronounced or expected.
- Upstream or cross-stream support transactions, including upstream and cross-stream guarantees, are more vulnerable to an avoidance challenge compared to downstream support transactions, such as downstream guarantees.

While the ex post review of intra-group financial transactions is necessary as a form of judicial protection, ensuring equal treatment of creditors and estate value preservation, the design of avoidance provisions – dating back to Roman law – makes it difficult to apply to transactions involving group members. As mentioned in Chapter 2, a group of companies is a relatively recent phenomenon. The quest is to achieve a balance between, on the one hand, maximising insolvency estate value, which depends on whether the transaction is properly compensated – not an easy calculation to be made ex ante and evaluated ex post, and, on the other hand, ensuring contractual predictability and legal certainty for the parties involved: principal debtor-borrower, group guarantor and outside lender. Transaction avoidance law is not shaped in a way that allows one to clearly foresee whether a group support transaction, such as a cross-guarantee, is voidable or not. As noted above, this is partially caused by the indeterminacy of (accepting) the "indirect" and "group" benefits. As a result, the outcome is problematic from a principle-based point of view. It is far from being optimal from the perspective of protecting legitimate expectations and the certainty of transactions. It is also disproportionate and harmful to the principle of estate value maximisation if the risk of transaction avoidance disincentivises efficient, value-enhancing transactions.

9 When Insolvency meets Freedom of Contract: Ipso Facto and Cross-default Clauses▪

9.1 Introduction

This chapter provides a general introduction to ipso facto and cross-default clauses, which are common in commercial practice, especially in loan and bond documentation, repurchase, and securities lending agreements. They also typically implicate several group entities. This is why their analysis and treatment in insolvency are necessary to comprehensively cover the subject of intra-group financing. Both types of clauses increase the power of a counterparty (creditor), as they grant the creditor the right to terminate, accelerate, or amend a contract with the debtor upon a specified event, often termed as an "event of default". This is akin to other contractual covenants granting a creditor additional means to control and police the debtor. Section 9.2. offers examples of ipso-facto and cross-default clauses and discusses their rationale.

When the contractually agreed triggering event relates to the debtor's (bad) financial situation, insolvency filing, commencement of insolvency proceedings, appointment of an IP, or a similar event, this clause will be referred to as an ipso facto clause, Latin for "by the fact itself". This indicates that termination and acceleration rights do not result from the debtor's default on a substantive obligation (e.g. payment and delivery obligations, provision of collateral) but follow from the very fact of occurrence of an insolvency-related event. Given that ipso facto clauses have an effect on reorganisation and could harm unsecured creditors, many legal systems, including those studied in this book, restrict freedom of contract and limit the effectiveness of ipso facto clauses in insolvency. The scope of such limitations is examined in section 9.3.

Cross-default clauses are similar to ipso facto clauses, as both grant a counterparty certain rights or options. Nevertheless, this book distinguishes them from ipso facto clauses, because they require a breach of a contract or failure to perform an obligation. The specificity of a cross-default is that such breach or failure on one obligation leads to a default on another obligation.

▪ This chapter builds upon the following previously published work by the author:
– I. Kokorin, Promotion of group restructuring and cross-entity liability arrangements, Journal of Corporate Law Studies, Vol. 21, 2021, pp. 557-593.

These obligations usually arise under different contracts concluded with the same creditor, another creditor, or even another group entity. Yet, just like ipso facto clauses, they can drive a borrower into insolvency by allowing acceleration or termination of a contract at the first signs of financial troubles. Hence, they contribute to creditor risk control and risk mitigation. That being said, cross-default clauses are treated differently in law. Unlike ipso facto clauses, they are generally held to be valid and enforceable. However, this does not mean that they are not affected by insolvency law. Section 9.4. shows how national law regimes deal with default-triggered clauses.

Section 9.5. summarises the ex post effects of ipso facto and cross-default clauses, specifically when an event of default relates to another group company and not to the direct counterparty. We argue that, like guarantees, such cross-entity or intercompany ipso facto and cross-default clauses link separate group companies and increase the correlation within an enterprise group, thereby producing a domino-like effect and weakening the insulation offered by corporate shields. This begs the question whether and under what circumstances restricting the ability of parties to contract is desirable. Section 9.6. concludes.

9.2 Ipso Facto and Cross-Default Clauses: Definition and Rationale

9.2.1 Ipso facto clauses

Ipso facto clauses are contractual provisions that grant a creditor the right to terminate, accelerate, or amend a contract, or to refuse performance under it, if there is an event of default. This event should be linked to the debtor's application for commencement or commencement of insolvency proceedings, appointment of an IP, financial distress, or even indicators that the debtor is in a weak financial position.[1] The operation of ipso facto clauses might be extended to encompass several group entities that are not the creditor's counterparties. For instance, a clause could stipulate that the creditor is entitled to suspend contractual performance or to terminate or amend the contract with a debtor-direct counterparty if any company with the debtor's group initiates an insolvency proceeding.

An example of such a cross-entity ipso facto clause, linking the event of default to an insolvency filing or similar actions related to the debtor or "any Material Subsidiary" is provided below. It relates to the securities

1 UNCITRAL Legislative Guide, Part two, Ch. II, para. 114.

issued by Oi S.A., the group's parent company, and guaranteed by its subsidiaries – a common group financing structure (see section 1.1.3.).

> *Events of Default*. An Event of Default occurs if:
>
> (6) the Company or any Material Subsidiary commences a voluntary case or other proceeding seeking liquidation, judicial or extrajudicial reorganization or other relief with respect to itself or its Indebtedness under any bankruptcy, insolvency or other similar law now or hereafter in effect, or seek the appointment of a trustee, receiver, judicial administrator (*administrador judicial*), liquidator, custodian or other similar official of it or any substantial part of its property, or consents to any such relief or to the appointment of or taking possession by any such official in an involuntary case or other proceeding commenced against it, or makes a general assignment or conveyance for the benefit of creditors;
>
> (7) a court of competent jurisdiction enters an order or decree against the Company or any Material Subsidiary for (a) liquidation, reorganization or other relief with respect to it or its Indebtedness under any bankruptcy, insolvency or other similar law now or hereafter in effect or (b) the appointment of a trustee, receiver, judicial administrator (*administrador judicial*), liquidator, custodian or other similar official of it or any substantial part of its property; *provided* that such order or decree shall remain undismissed and unstayed for a period of 90 calendar days;[2]

The examples of ipso facto clauses can also be found in the Loan Market Association (LMA) documentation, including the Multicurrency Term and Revolving Facilities Agreement. This Agreement refers to both the financial situation of the debtor or its group members, initiation of negotiations with creditors, and taking steps towards reorganisation as an Event of Default:

> 23.6 **Insolvency**
> (a) A member of the Group[3]:
> (i) is unable or admits inability to pay its debts as they fall due;
> (ii) suspends making payments on any of its debts; or
> (iii) by reason of actual or anticipated financial difficulties, commences negotiations with one or more of its creditors (excluding any Finance Party in its capacity as such) with a view to rescheduling any of its indebtedness. […]

2 Indenture, 10.000%/12.000% Senior PIK Toggle Notes due 2025, Dated as of July 27, 2018 <https://www.sec.gov/Archives/edgar/data/1160846/000119312518265177/d517628dex42.htm> (accessed 15 July 2023).

3 Under the LMA Multicurrency Term and Revolving Facilities Agreement, "Group" is defined as "the Company and its Subsidiaries for the time being".

> 23.7 **Insolvency proceedings**
> Any corporate action, legal proceedings or other procedure or step is taken in relation to:
> (a) the suspension of payments, a moratorium of any indebtedness, winding-up, dissolution, administration or reorganisation (by way of voluntary arrangement, scheme of arrangement or otherwise) of any member of the Group other than a solvent liquidation or reorganisation of any member of the Group which is not an Obligor;
> (b) a composition, compromise, assignment or arrangement with any creditor of any member of the Group; […]

According to Wood, the goal 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."[4] Terminating a contract in a situation of the debtor's financial distress can reduce the risk of prospective (potential) non-performance. Since the debtor's or its group member's financial distress, reorganisation attempt, negotiations with creditors over debt restructuring, and other similar events or actions often indicate increased risks for the creditor, the argument goes that the creditor should be able to rely on a contractual clause to pull out of the deal by terminating or accelerating the contact. In other words, insolvency-related events are used as a proxy for evidence of increased credit risk.

Di Gennaro and Goldstein note the policing function of ipso facto clauses and compare them to financial or restrictive covenants in loan agreements, such as restrictions on debt levels and minimum cash flows and net assets. Both seek to deter the debtor from engaging in excessively risky or opportunistic behaviour by creating a threat of contract termination or acceleration, whether automatic or not.[5] This prophylactic role of ipso facto clauses was also mentioned by Che and Schwartz, who argue that such 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.[6] To the extent that ipso facto clauses promote risk mitigation and give additional means of control to a creditor, they can reduce the agency costs of debt.

---

4 P. Wood, Principles of International Insolvency, 2nd edn, Sweet & Maxwell, 2007, para. 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."

5 M.J. Di Gennaro, H.J. Goldstein, Can Ipso Facto Clauses Resolve the Discharge Debate? An Economic Approach to Novated Fraud Debt in Bankruptcy, DePaul Business and Commercial Law Journal, Vol. 1, 2003, p. 435. Jackson refutes this argument by pointing out that the actual cost is borne by unsecured creditors and not the debtor or its shareholders. T.H. Jackson, The Logic and Limits of Bankruptcy Law, Beard Books, 2001, pp. 42-43.

6 Y-K. Che, A. Schwartz, Section 365, Mandatory Bankruptcy Rules and Inefficient Continuance, Journal of Law, Economics, & Organization, Vol. 15, 1999, pp. 441-467.

9.2.2 Cross-default clauses

According to Black's Law Dictionary, a cross-default clause is a "contractual provision under which default on one debt obligation triggers default on another obligation."[7] Cross-default clauses are commonly seen in debt financing documents, such as syndicated loan and bond contracts.[8] They are distinct from simple defaults as cross-defaults refer to separate obligations or contracts, often concluded between different parties.[9] In a common group scenario, a default on the obligation of one group entity may automatically trigger a default on the obligation of an affiliated entity, even though, apart from a cross-default, the borrower may have met all of its own obligations to the particular lender.[10] The examples below refer to the performance by the Borrower, and "any Material Subsidiary", or "any member of the Group".

The above-mentioned LMA Multicurrency Term and Revolving Facilities Agreement contains the following description of a cross-default:

> 23.5 **Cross default**
> (a) Any Financial Indebtedness[11] of any member of the Group is not paid when due nor within any originally applicable grace period.
> (b) Any Financial Indebtedness of any member of the Group is declared to be or otherwise becomes due and payable prior to its specified maturity as a result of an event of default (however described). […]

Another example of a cross-default provision is the following clause, included in the USD 750 million unsecured credit facility agreement, entered into between Darden Restaurants Inc. and a group of lenders:

---

7 B.A. Garner (ed), Black's Law Dictionary, 8th edn, Thomson West, 2004, p. 405.

8 See N. Li, Y. Lou, F.P. Vasvari, Default clauses in debt contracts, Review of Accounting Studies, Vol. 20, 2015, pp. 1596-1637; J. Gruber, Cross-default clauses in finance contracts, International Business Law Journal, 5, 1997, pp. 591-603; P. Wood, Principles of International Insolvency, 2nd edn, Sweet & Maxwell, 2007, para. 21-006, noting that cross-default clauses are standard in bonds, although they tend to be less comprehensive compared to those in bank credit agreements.

9 Gullifer and Payne consider cross-defaults "non-breach events", because the debtor does not directly breach the contract that is terminated. L. Gullifer and J. Payne, Corporate Finance Law: Principles and Policy, 3rd edn, Hart Publishing, 2020, p. 223; E. Ferran and L.C. Ho, Principles of Corporate Finance Law, 2nd edn, OUP, 2014, p. 294.

10 A.J. Casey, The New Corporate Web: Tailored Entity Partitions and Creditors' Selective Enforcement, The Yale Law Journal, Vol. 124, 2015, p. 2689, explaining that the "inter-entity cross default will cause a loan to one entity to be in default whenever an affiliated entity defaults on a debt obligation."

11 "Financial Indebtedness" means any indebtedness for or in respect of, inter alia, moneys borrowed, any amount raised by acceptance under any acceptance credit facility, any amount raised pursuant to any note purchase facility or the issue of bonds, notes or debentures, etc.

> Cross-Default. The Borrower or any Material Subsidiary (i) fails to make any payment when due (whether by scheduled maturity, required prepayment, acceleration, demand, or otherwise) in respect of any Material Indebtedness, or (ii) fails to observe or perform any other agreement or condition relating to any Material Indebtedness, or any other event occurs, the effect of which default or other event is to cause or to permit the holder or holders of such Material Indebtedness to cause, with the giving of notice if required, such Material Indebtedness to become due prior to its stated maturity; […][12]

In this book, we distinguish between ipso facto and cross-default clauses, even though in practice such a distinction may not be clear-cut. Unlike insolvency-triggered ipso facto clauses, cross-default clauses are tied to non-performance of an obligation or any other form of "misbehaviour" or a breach of a contract (e.g. failure to pay amounts due), whether by a direct counterparty or by another person. Cross-default arrangements are similar to cross-guarantees in the sense that both require some form of default. Indeed, cross-guarantees might be coupled with cross-default provisions.[13] That being said, the rationale and effect of intercompany cross-defaults are quite distinct from group guarantees. The main difference is that cross-default clauses do not grant a creditor access to asset pools of separate companies. Rather, they seek to discipline the debtor, deter breaches, and produce additional monitoring benefits because creditors can better calculate and control risks related to the group's operations.[14] Even though monitoring costs are not fully eliminated,[15] they are reduced. A default by one group entity sends a signal to the creditor that the whole group may be in trouble. In anticipation of financial problems, a cross-default provision entitles the creditor to refuse future performance (e.g. to stop continuous lending under the revolving credit facility) or accelerate its existing claims. In other words, this creditor does not need to wait for its direct counterparty to default before enforcing its claim. In this way, cross-defaults permit the

---

12 Darden Restaurants $750,000,000 Credit Agreement dated 20 September 2007 <https://www.sec.gov/Archives/edgar/data/940944/000119312507205607/dex101.htm> (accessed 15 July 2023).

13 A.J. Casey, The New Corporate Web: Tailored Entity Partitions and Creditors' Selective Enforcement, The Yale Law Journal, Vol. 124, 2015, p. 2680.

14 R. Youard, Default in International Loan Agreements – Part 2, Journal of Business Law, 1986, p. 385, explaining that lenders want a "cross-default clause to be wide enough to give early warning of a wider range of situations than may be strictly necessary, simply because it is difficult to predict the future with accuracy and lenders want to be in a position to make their own decision as to whether the event in question is in fact the tip of the iceberg."

15 K. Clark, A. Taylor, Events of Default in Eurocurrency Loan Agreements, International Financial Law Review, Vol. 1, 1982, p. 13, noting that in practice usefulness of cross-default clauses "may be curtailed by the standards of secrecy which banks are accustomed and expected to maintain." One bank might be unaware of a cross-defaulting event. Arguably, monitoring intercompany cross-defaults is even more difficult. Cross-entity monitoring is equally problematic for bonds, as bond financing could lack centralised supervision and control over the issuer or its group entities.

withdrawal of investment at the first sign of financial troubles. The same reasoning was mentioned before with respect to ipso-facto clauses.

Following a cross-default, the threat of contract termination or acceleration might be used to force a contract renegotiation for the benefit of the creditor.[16] This forced renegotiation could concern the way the debtor or the wider enterprise group is managed or doing business (e.g. cost-cutting, sale of assets), thereby giving the creditor an important governance role when the debtor experiences financial difficulties. In sum, cross-default clauses are conducive to risk mitigation, promotion of collection and enhancement of creditor's governance.[17] They seek to improve creditor oversight and may to some extent counteract the creditor disengagement caused by cross-guarantees.

9.3 Enforceability of Ipso Facto Clauses

9.3.1 The UK: contracts for supply of goods or services

Historically, ipso facto clauses have been permitted as emanating from the principle of freedom of contract. The underlying party autonomy is at the heart of English commercial law. It was held to be desirable that the "courts give effect to contractual terms which parties have agreed."[18] The case for party autonomy is particularly compelling when dealing with complex financial instruments or arrangements involving large corporate groups and parties with equal bargaining power.[19]

Under English law, prior to the most recent reforms (i.e. CIGA), it was generally assumed that provisions for the termination of a contract upon insolvency or liquidation of a party were valid.[20] The UK Supreme Court

16 Instead of exercising acceleration rights, lenders can also choose to request a fee for waiving the default. See L. Hornuf, M. Reps, S. Schäferling, Covenants in European investment-grade corporate bonds, Capital Markets Law Journal, Vol. 10, 2015, p. 358.

17 D. Hahn, The Roles of Acceleration, DePaul Business and Commercial Law Journal, Vol. 8, 2010, p. 231, arguing that "beyond facilitating collection, acceleration's primary role is to enhance a creditor's control and governance."

18 *Perpetual Trustee Company Ltd & Anor v. BNY Corporate Trustee Services Ltd & Ors* [2009] EWCA Civ 1160, at 58.

19 Ibid.

20 A few exceptions applied to the supply of utilities, such as gas, water, and electricity (section 233 Insolvency Act 1986). With the adoption of the Insolvency (Protection of Essential Supplies) Order 2015, protection against termination of essential supplies was extended to cover communication and other electronic services and hardware under sections 233 and 233A Insolvency Act 1986 (information, advice and technical assistance in connection with the use of IT, data storage and processing, website hosting, etc.). Finch and Milman note that the inclusion of new provisions, applicable after 1 October 2015, "represents a considerable victory for the business recue lobby." V. Finch, D. Milman, Corporate Insolvency Law: Perspectives and Principles, 3rd edn, CUP, 2017, p. 515.

confirmed this view in *Belmont Park Investments Pty Ltd*,[21] as long as these provisions did not breach the anti-deprivation rule. This rule protects creditors by preserving the assets of a debtor on or after the onset of insolvency.[22] Its main purpose is to prevent the "intentional or inevitable evasion of the principle that the debtor's property is part of the insolvent estate."[23] The scope of the anti-deprivation rule is limited and narrow.[24] It does not apply 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."[25] Ipso facto clauses typically do not have as their "main" purpose the deprivation of the debtor of its property, particularly in financial transactions.[26] Thus, these clauses would generally be considered commercially sensible and therefore are likely to survive the anti-deprivation rule.[27] In this respect, a distinction is made between "a commercial re-arrangement of rights to reflect the economic consequences of insolvency and an attempt to pre-empt the distribution of assets in a bankrupt estate."[28] This is a quid pro quo analysis.

---

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

22 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); *Mayhew v. King* [2011] EWCA Civ 328, concluding that a clause that releases a chose in action (claim) upon insolvency, effectively removing the asset from the debtor's creditors, infringes the anti-deprivation principle. The purported "contracting out" of the insolvency legislation is contrary to public policy.

23 *Belmont Park Investments Pty Ltd v. BNY Corporate Trustee Services Ltd Butters v. BBC Worldwide Ltd* [2011] UKSC 38, at 106.

24 F. Toube, J. Rumley, A Brave New World? Should the UK Ban Ipso Facto Clauses in Non-Executory Contracts? Insolvency Intelligence, 31(3), 2018, p. 78; L. Gullifer, J. Payne, Corporate Finance Law: Principles and Policy, 3rd edn, Hart Publishing, 2020, p. 111, noting that "the principle is of limited application"; E. Vaccari, The normative and jural meanings of the anti-deprivation principle *vis-à-vis* freedom of contract, International Insolvency Review, Vol. 31, 2022, pp. 235-274.

25 *Belmont Park Investments Pty Ltd v. BNY Corporate Trustee Services Ltd Butters v. BBC Worldwide Ltd* [2011] UKSC 38, at 104.

26 B. Wessels, S. Madaus (eds), Rescue of Business in Europe: A European Law Institute Instrument, OUP, 2020, p. 208. Goode convincingly argues that a contractual right may in practice constitute a valuable asset, whose termination can diminish assets available to creditors, "so that in form and in substance the termination operates as forfeiture." R. Goode, Principles of Corporate Insolvency Law, 4th edn, Sweet & Maxwell, 2011, p. 222.

27 *Fibria Celulose S/A v Pan Ocean Co. Ltd & Anor* [2014] EWHC 2124 (Ch). Notably, in 2020, the Supreme Court of Canada in *Chandos Construction Ltd v. Deloitte Restructuring Inc*, 2020 SCC 25, confirmed an effects-based approach in Canada to the anti-deprivation rule. This is in contrast to the commercial reasonableness test adopted in the UK. Hence, ipso facto clauses are likely to be held unenforceable in Canada pursuant to common law. This is in addition to the statutory prohibitions implemented over the last few decades. See J. Sarra, J. Payne, S. Madaus, The Promise and Perils of Regulating Ipso Facto Clauses, International Insolvency Review, Vol. 31, 2022, p. 49 and p. 54.

28 *Lomas v. JFB Firth Rixson Inc* [2012] 2 All.E.R. (Comm) 1076, at 91.

The CIGA came into force on 26 June 2020 and introduced new procedures and measures to rescue companies in financial distress.[29] Among other innovations, the insolvency law reform has led to the limitation of ipso facto clauses, which cease to have effect. According to section 233B(3) of the Insolvency Act 1986:

> A provision of a contract for the supply of goods or services to the company ceases to have effect when the company becomes subject to the relevant insolvency procedure if and to the extent that, under the provision (a) the contract or the supply would terminate, or any other thing would take place, because the company becomes subject to the relevant insolvency procedure, or (b) the supplier would be entitled to terminate the contract or the supply, or to do any other thing, because the company becomes subject to the relevant insolvency procedure.

The limitation is linked to the opening of the "relevant insolvency procedure", which includes the majority of insolvency or liquidation procedures, including the new standalone moratorium, Part 26A restructuring plan (but not schemes of arrangement[30]), administration, company voluntary arrangement and liquidation. The inclusion of the liquidation procedure in the list of relevant procedures is puzzling since it does not aim to rescue companies in financial distress. Typically, liquidation results in the immediate cessation of trading for the debtor company and the piecemeal sale of its assets.[31]

Many contracts are excluded from the scope of the rule that curbs the effectiveness of ipso facto clauses. For example, the carve-out extends to loans, financial leases, swap agreements and the provision of guarantees and commitments.[32] It also covers specified categories of persons involved in financial services, such as depository and investment banks, insurers and

---

29 For background of reforms, see S. Frisby, Of rights and rescue: a curious confluence? Journal of Corporate Law Studies, Vol. 20, 2020, pp. 39-72.

30 Wood notes that since schemes of arrangement are not considered to be insolvency procedures, they "usually will not spark insolvency forfeiture clauses in contracts or leases or cross-default clauses in bonds." P. Wood, Principles of International Insolvency, 2nd edn, Sweet & Maxwell, 2007, para. 23-038. Interestingly, schemes are included in the relevant ipso facto rules in Australia (Corporations Act 2001, s. 415D) and Singapore (IRDA, s. 440(6)).

31 S. Paterson, The analytical boundary between corporate reorganisation and sale in corporate bankruptcy theory, in P.J. Omar and J.L.L. Gant (eds), Research Handbook on Corporate Restructuring, Edward Elgar Publishing, 2021, p. 537, observing that if the policy behind the ban is to solve the collective action problem, "then it seems surprising that it may apply where the strategy for the bankruptcy case is to sell assets on a break-up basis."

32 Schedule 4ZZA to the Insolvency Act 1986. Other contracts may also be excluded as not being contracts for the "supply of goods or services". These include licenses, property leases and agreements for the sale of land. See Explanatory notes to CIGA, para. 231 <https://www.legislation.gov.uk/ukpga/2020/12/notes/division/6/index.htm> (accessed 15 July 2023).

investment firms.[33] These persons are excluded from section 233B, irrespective of whether they are an insolvent debtor or the supplier. As a result, parties involved in the carved-out matters can still withdraw committed funds, change default interest, accelerate debt and call up guarantees upon a debtor's insolvency filing and other insolvency-related events. Arguably, this carve-out is essential because, without it, financial creditors might be incentivised to incorporate earlier triggers in their contracts, potentially leading to withdrawals at a point where insolvency is merely likely. Given the focus of this book on financial arrangements, such as loans, bonds, and guarantees, the ineffectiveness of ipso facto clauses under English law is of limited relevance for our discussion. Thus, the principle of freedom of contract continues to prevail, governing the attitude towards ipso facto clauses in intra-group financing.

9.3.2 The USA: executory contracts and safe harbours

Before the enactment of the Bankruptcy Reform Act of 1978, ipso facto clauses were honoured under US bankruptcy law.[34] Although in a number of cases they were not treated with favour,[35] express and unambiguous contractual clauses and covenants of forfeiture – in effect ipso facto clauses – were held to be enforceable against the trustee in bankruptcy. This was irrespective of the nature of proceedings, insolvent liquidation or reorganisation.

Just like in the UK, the change in the attitude toward the validity of ipso facto clauses in the USA required statutory intervention. This happened with the adoption of the US Bankruptcy Code in 1978. The shift towards the prohibition of ipso facto clauses can be attributed to the overall move in the direction of rehabilitating financially troubled companies.[36] Levitin explains

33 Schedule 4ZZA to the Insolvency Act 1986.

34 For a detailed historical account, see V. Countryman, Executory Contracts in Bankruptcy: Part II, Minnesota Law Review, Vol. 58, 1974, pp. 479-567.

35 In a few cases, courts, guided by considerations of equity and public interest, barred the enforcement of ipso facto clauses in order to prevent 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); *Queens Blvd. Wine & Liquor Corp. v. Blum*, 503 F.2d 202 (2d Cir. 1979).

36 S. Block-Lieb, Fishing in Muddy Waters: Clarifying the Common Pool Analogy as Applied to the Standard for Commencement of a Bankruptcy Case, American University Law Review, Vol. 42, 1993, p. 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.

that "there is a strong general bankruptcy policy concern about ipso facto clauses because [they] can function as punitive liquidated damages provisions and work at odds with Chapter 11's reorganisation preference and with Chapter 7's equitable distribution principle."[37]

To promote the debtor's rescue prospects and protect the debtor from losing valuable contractual rights, the US Bankruptcy Code limits freedom of contract and deprives ipso facto clauses of their legal force. In addition to invalidating ipso facto clauses, the law excuses them from the cure requirements for assumption purposes.[38] As a result, any defaults on account of ipso facto clauses could be ignored, and a counterparty may not terminate the contract or demand payment based solely on an event of default triggered by an ipso facto clause.

The US Bankruptcy Code stipulates in § 365(e)(1) that:

> Notwithstanding a provision in an executory contract or unexpired lease, […] an executory contract or unexpired lease of the debtor may not be terminated or modified, and any right or obligation under such contract or lease may not be terminated or modified, at any time after the commencement of the case solely because of a provision in such contract or lease that is conditioned on -
> (A) the insolvency or financial condition of the debtor at any time before the closing of the case;
> (B) the commencement of a case under this title; or
> (C) the appointment of or taking possession by a trustee in a case under this title or a custodian before such commencement.[39]

Under this provision, a clause providing for the termination or modification of an executory contract or lease conditioned on the debtor's insolvency, commencement of a bankruptcy case, or the appointment of a receiver or custodian is inoperative. The prohibition of ipso facto clauses also extends to clauses that have the same effect as a clause triggered by a bankruptcy filing. For instance, a clause conditioned on the debtor's financial health or the increased financial risks is invalid "because it is most likely to operate in the vicinity of a bankruptcy case."[40] Financial distress is usually a good indicator of a forthcoming bankruptcy filing.

From § 365(e)(1), it follows that the limits imposed on ipso facto clauses apply only to contracts which are considered to be *executory*, and to unexpired leases. Whereas the meaning of the latter is not controversial, the former has become an arena for fierce litigation and has led to different

---

37 A.J. Levitin, Business Bankruptcy: Financial Restructuring and Modern Commercial Markets, Wolters Kluwer, 2016, p. 840.

38 11 U.S. Code § 365(b)(2).

39 11 U.S. Code § 365(e)(1).

40 Collier on Bankruptcy, 16th edn, 2022, Vol. 3, ¶ 365.08[1].

interpretations.[41] Courts have had great difficulty in developing a workable and coherent definition of what constitutes an executory contract. As one commentator observed, the law of executory contracts in bankruptcy law is characterised by "a hopelessly convoluted and contradictory jurisprudence."[42] We will not try to cover different approaches and definitions but instead consider an executory contract to be a contract in which both parties continue to have ongoing obligations to each another. In other words, performance remains due to some extent on both sides.[43] If performance by one party to the contract has been fully completed, it is no longer an executory contract. This is why loan agreements are typically not considered to be executory, as one of the parties (e.g. lender) does not have ongoing material obligations. This is the case where the loan is fully funded.[44]

But what if the lender has material outstanding obligations?[45] Some courts have held broadly that "loan agreements are generally not considered to be executory contracts" and therefore ipso facto clauses contained therein

41 J.A.E. Pottow, A New Approach to Executory Contracts, Texas Law Review, Vol. 96, 2018, p. 1438, noting that "a judicial cottage industry in bankruptcy has developed on the definition of "executoriness" and concomitant scope of access to § 365."

42 M.T. Andrew, Executory Contracts Revisited: A Reply to Professor Westbrook, University of Colorado Law Review, Vol. 62, 1991, p. 2. See also J.L. Westbrook, K.S. White, The Demystification of Contracts in Bankruptcy, American Bankruptcy Law Journal, Vol. 91, 2017, pp. 481-562.

43 The term "executory contract" is not defined in the US Bankruptcy Code. There are essentially three approaches to executoriness. One of them refers to the definition suggested by Countryman (so-called Countryman Test). Under it, an executory contract is "a contract under which the obligation of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other." V. Countryman, Executory Contracts in Bankruptcy: Part I, Minnesota Law Review, Vol. 57, 1973, p. 460. *In re Perm Traffic Co.*, 524 F.3d 373, 379 (2d Cir. 2008); *In re Weinstein Co. Holdings LLC*, 997 F.3d 497, 504 (3d Cir. 2021). The materiality of the breach under the Countryman Test is a factual question resolved through the application of state law. Another, similar but less stringent test is a "some performance due" standard cited in the legislative history. *In re Waldron*, 36 B.R. 633 (Bankr. S.D.Fla. 1984). The third approach is the functional one. According to it, "the question of whether a contract is executory is determined by the benefits that assumption or rejection would produce for the estate." *Sipes v. Atlantic Gulf Communities Corp.*, 84 F.3d 1364, 1375 (11th Cir.1996). See J.L. Westbrook, A Functional Analysis of Executory Contracts, Minnesota Law Review, Vol. 74, 1989, pp. 227-338.

44 *In re Calpine Corp.*, 50 Bankr. Ct. Dec. 92, 2008 WL 3154763 (Bankr. S.D. N.Y. 2008), noting that there were no mutual performance obligations, because there was no performance remaining due from the lender under the loan agreement. *In re Moody Nat. SHS Houston H, LLC*, 426 B.R. 667 (Bankr. S.D. Tex. 2010), holding that a mortgage note was neither a lease nor an executory contract. See also H.R. Rep. No. 95-595, 2d Sess. 347, reprinted in 1978 U.S. Code Cong. & Admin. News, pp. 5963 ("note is not usually an executory contract if the only performance that remains is repayment.").

45 E.A. Kleinhaus, P.B. Zuckerman, The Enforceability of Ipso Facto Clauses in Financing Agreements: American Airlines and Beyond, Norton Journal of Bankruptcy Law and Practice, Vol. 23, 2014, pp. 193-211.

are valid and enforceable (e.g. triggering the lender's right to interest at the default rate).[46] In a few other cases, it was simply assumed and not disputed by the parties that financing agreements are non-executory.[47] A more nuanced view is that a credit agreement can be an executory contract if the lender has unfulfilled loan commitments.[48] The minority of courts have adopted the position that the bar on ipso facto clauses extends beyond situations directly addressed in the US Bankruptcy Code, such that an ipso facto ban can also apply to non-executory contracts.[49]

The difficulty of determining whether a contract is executory also applies to guarantee arrangements, such as surety bonds. In the tripartite relations, one party (surety) is liable for the principal's or obligor's debt or duty to the third-party obligee (creditor). In *Argonaut Insurance Company v. Falcon V, L.L.C.*,[50] the principal debtors (Debtors) contracted with Argonaut (surety) to issue irrevocable performance bonds that would cover claims of the third-party lessors (creditors). In exchange, Debtors agreed to pay premiums and indemnify Argonaut for claims of third parties, should Argonaut be required to satisfy them.

Following the Debtor's Chapter 11 filing, Argonaut argued that the surety bond program was deemed assumed by the plan because it was not rejected. Debtors responded that the surety bond program was not an executory contract and that Argonaut's claims had been discharged in bankruptcy. The court concluded that the surety bond was not an executory contract because Argonaut owed no additional performance to Debtors after posting the surety bonds. The only remaining duty of Argonaut was a contingent

---

46 *In Re General Growth Properties, Inc.*, 451 B.R. 323 (Bankr. S.D.N.Y. 2011).

47 See e.g. *In re AMR Corp.*, 485 B.R. 279, 296-97 (Bankr. S.D.N.Y. 2013) ("As both U.S. Bank and the Debtors admit that the Indentures here are not executory contracts or unexpired leases […] the Court concludes that […] is not an invalid ipso facto clause"); *In re A & B Assocs., L.P.*, 2019 WL 1470892 (Bankr. S.D. Ga. Mar. 29, 2019) ("Neither party has asserted that the Loan Agreement is an executory contract, much less an unexpired lease").

48 *In re Cardinal Industries, Inc.*, 146 B.R. 720, 730 (Bankr. S.D. Ohio 1992), concluding that a credit agreement was an executory contract, because each party had remaining "material" obligations under it. *Whinnery v. Bank of Onalaska (In re Taggatz)*, 106 B.R. 983, 991 (Bankr. W. D. Wis.1989), finding that a contract is executory where the debtor owed on a note and the bank had not completely funded the note.

49 *In re W.R. Grace & Co.*, 475 B.R. 34, 153 (D. Del. 2012), refusing to enforce an ipso facto clause that would have entitled the lender with default interest upon the debtor's insolvency filing and holding that the "ban on ipso facto clauses has been interpreted to be much broader than the confines of §§ 541(c) and 365(e)(1)." The court referred to *In re Rose*, 21 B.R. 272 (Bankr. D.N.J.1982), finding that even though the contract in issue was non-executory, the bankruptcy-related default clause could still not be enforced because it was contrary to the central purpose of the US Bankruptcy Code.

50 *Argonaut Insurance Company v. Falcon V, L.L.C.*, 2021 WL 4486336 (M.D. La. 2021), affirming *In re Falcon V, L.L.C.*, 620 B.R. 256 (Bankr. M.D.La. 2020). For similar findings, see *In re James River Coal Co.*, 2006 WL 2548456 (M.D. Tenn. 2006).

obligation to third parties. The court also pointed out that Debtor's failure to perform (i.e. pay bond premiums) did not create a material breach that could excuse Argonaut's performance. Instead, such a failure expressly triggered Argonaut's obligations under the surety bond.

On appeal, Argonaut emphasised that it still owed obligations to third parties under the surety bond program and that these obligations should be taken into account when deciding whether the contract in question was executory or not. Importantly, the Fifth Circuit accepted that courts should apply the relevant test "to multiparty contracts in a flexible manner that accounts for the various obligations owed to all of the parties, rather than focusing exclusively on the flow of obligations between the debtor and the creditor."[51] Nevertheless, it concluded that the surety contract was not executory because the surety would not be excused from its obligations even if Debtors failed to perform, since the performance bonds were irrevocable. In another, much earlier case, however, it was held that a surety bond contract, a contract between a surety and a principal debtor, was "clearly executory".[52]

The cited cases concern the legal relationship between the principal debtor and the guarantor (*bankrupt debtor → guarantor*). US courts also considered whether the guarantee itself, as a relationship between the bankrupt guarantor and the creditor (*bankrupt guarantor → creditor*), falls within the term "executory contract". They generally found that a guarantee was not an executory contract.[53] As one court concluded in this respect, the "guarantor is […] no more entitled to reject his agreement of guaranty than would any bankrupt be entitled to 'reject' his accrued debts."[54] Finally, when it comes to the relationship between the creditor and a non-bankrupt guarantor (*creditor → non-bankrupt guarantor*), one court determined that the non-bankrupt guarantor cannot benefit from the bankruptcy prohibition of ipso facto clauses in a situation where the payment obligation is triggered by the bankruptcy of the debtor. The court accepted that the law does not explicitly state that only the bankrupt can invoke an ipso facto ban but argued that the rule against ipso facto clauses was introduced to protect against the clauses diluting the bankrupt's interests – not the interests of a third party.[55] Notably, the court clarified that it did not mean to say that a third non-bankrupt party can never rely on § 365(e)(1).

51 *Matter of Falcon V, L.L.C.*, 44 F.4th 348, 354 (C.A.5 (La.), 2022).
52 *In re Evans Products Co.*, 91 B.R. 1003 (Bankr. S.D. Fla. 1988).
53 *In re Furniture Brands International, Inc.*, 2013 WL 9065131 (Bankr. D.Del. 2013), noting that the guarantee does not contain ongoing material obligations to the guarantor by the creditor.
54 *In re Grayson–Robinson Stores, Inc.*, 321 F.2d 500, 502 (2d Cir.1963).
55 *Liberty Mut. Ins. Co. v. Greenwich Ins. Co.*, 417 F.3d 193 (1st Cir. 2005).

The US Bankruptcy Code includes a number of exceptions (safe harbours) that permit the enforcement of ipso facto clauses in contracts, typically concluded with sophisticated financial participants, even if these contracts are executory (securities contracts, commodities and forward contracts, repos, swaps, master netting arrangements, etc.).[56] Crucially for the purposes of this book, the law also explicitly excludes from the scope of the ipso facto ban an executory contract that is "a contract to make a loan, or extend other debt financing or financial accommodations, to or for the benefit of the debtor, or to issue a security of the debtor."[57]

Hence, if a loan agreement is considered to be executory, a lender could terminate such an agreement, or refuse to make additional payments or grant future credit (e.g. pursuant to a revolving credit facility) upon the commencement of a bankruptcy case.[58] This prevents the trustee or debtor in possession from requiring new advances of money or other property under the existing financial contracts. As a result, pre-petition creditors cannot be forced to extend further credit after the bankruptcy petition has been filed. Therefore, whether a loan agreement is executory or non-executory may have no real difference. If it is non-executory, the ban on ipso facto clauses, pursuant to the prevailing view, does not apply (*non-executory → ipso facto clause allowed*). If it is executory, as may be the case of a revolving credit facility, the ipso facto ban will equally have no bearing (*executory, but exception applies → ipso facto clause allowed*). Either way, the lender is able to terminate the contract and refuse advancing additional funds to the bankrupt, even if the lender had an obligation to do so. This brings US law closer to English law, as both seek to safeguard the effectiveness of ipso facto clauses in financial contracts.

---

56 See e.g. 11 U.S. Code § 555-561. For discussion of rationale behind safe harbors, see M.D. Sherrill, In Defense of the Bankruptcy Code's Safe Harbors, The Business Lawyer, Vol. 70, 2015, pp. 1007-1037.

57 11 U.S. Code § 365(e)(2)(b). The term "financial accommodations" is not explained in the US Bankruptcy Code but courts define it narrowly as the extension of money or credit to accommodate another. In a number of cases, it was held that guaranty and surety contracts and other contracts the principal purpose of which is to extend financing to or guarantee the financial obligations are contracts to extend financial accommodations. See *In re Sun Runner Marine, Inc.*, 945 F.2d 1089 (9th Cir.1991), concerning an agreement between a financial institution and the debtor (a boat manufacturer), under which the financial institution made loans to the debtor's boat dealers, but the proceeds of the loans were disbursed directly to the debtor, and the debtor incurred secondary liability for the repayment of the loans to dealers. *In re Falcon V, L.L.C.*, 620 B.R. 256 (Bankr. M.D.La. 2020), concluding that the surety bond program is a financial accommodation. See also *In re Wegner Farms Co.*, 49 B.R. 440 (Bankr. N.D. Iowa 1985); *In re Thomas B. Hamilton Co.*, 969 F.2d 1013 (11th Cir. 1992).

58 *Mims v. Fidelity Funding, Inc.*, 307 B.R. 849 (N.D. Tex. 2002), holding the acceleration clause in a loan agreement enforceable as falling under the exception of § 365(e)(2)(b); *In re Marcus Lee Associates, L.P.*, 422 B.R. 21 (Bankr. E.D. Pa. 2009); *In re Watts*, 876 F.2d 1090 (3d Cir. 1989).

9.3.3 The Netherlands: WHOA schemes and obligations towards debtors

Dutch law does not contain a general rule on ipso facto clauses.[59] In a few cases, Dutch courts have considered ipso facto clauses to be valid and enforceable based on the specific facts of each individual case.[60] Their effectiveness was recognised by the Dutch Supreme Court in *BaByXL/ALM*.[61] In this case, the court analysed a provision in the agreement for the lease of computer equipment. The provision in question entitled the lessor to terminate the agreement if the lessee entered the suspension of payments procedure, and to claim compensation up to an amount equal to all the remaining lease payments that would have been chargeable under normal performance of the agreement.

The lessee argued that the purpose of the suspension of payments was to keep the debtor's business going, which, according to the lessee, would not be achieved if the lessor had the right to terminate the lease agreement prematurely. The court disagreed and held that Dutch law did not preclude the inclusion of a provision such as the one at hand in the lease agreement that offers the lessor an option to terminate the lease agreement prematurely in the event of the suspension of payments (a type of procedure under Fw). It noted that Article 238 Fw offers the tenant an option to prematurely terminate the lease in the interests of the estate. Yet it does not prohibit (early) termination of the lease by the lessor.

The court reminded that, as a general rule, neither bankruptcy nor suspension of payments affected the existing agreements of the debtor and did not deprive the lessor of contractual rights. This conclusion did not change because of the rehabilitative nature of the procedure. However, it was observed that Article 6:248(2) BW could in principle be invoked to refuse giving effect to a provision in a contract if such effect would be unacceptable (*onaanvaardbaar*) in the given circumstances according to the standards of reasonableness and fairness. This is especially so in a situation where the continued payment of rent is guaranteed. Yet in this case, the court did not have to consider whether the clause was unacceptable under the standards of reasonableness and fairness, as the issue was not raised on appeal.

---

59 Like English law before the CIGA reforms, Dutch law before the WHOA contained a single provision limiting ipso facto clauses in contracts concerning utilities – gas, water, electricity and heating necessary for the continuation of the debtor's business. See Articles 37b and 237b Fw.

60 D. Faber and N. Vermunt, National Report for the Netherlands, in D. Faber et al. (eds), Treatment of Contracts in Insolvency, OUP, 2013, para. 12.95.

61 HR 13 May 2005, *JOR* 2005/222, *NJ* 2005/406, m.nt. P. van Schilfgaarde (*BaByXL/ALM*).

Another case where an ipso facto clause was scrutinised is *Megapool/Laser*.[62] Megapool BV (Megapool) was a retail chain that sold kitchen and household appliances. Laser Nederland BV (Laser) and Megapool concluded an agreement under which consumers were allowed to use Laser's credit when financing purchases from Megapool. To this end, consumers were given a card, the MegaCard, with which they could make purchases within the limits of the credit facility made available to them by Laser. If a consumer used this card for a purchase at Megapool, the purchase amount was paid directly to Megapool by Laser. If a consumer had not paid Laser the purchase amount within six months, he was obliged to take out a loan with Laser for a term of up to three years. In such a case, Megapool received a commission from Laser. However, the right to the commission lapsed upon certain events, including termination of the agreement due to the insolvency of a counterparty. Magapool was declared bankrupt in 2004, and Laser terminated the agreement with it.

The trustees of Megapool took the position that the termination of the agreement by Laser did not result in a loss of Megapool's right to the commission. They argued that the clause affecting such a right was null and void due to being contrary to public policy (*openbare orde*) and good morals (*goede zeden*)[63] as it disproportionately affected creditors in the event of insolvency. The trustees claimed that reliance on the aforementioned clause was unacceptable according to standards of reasonableness and fairness.[64]

The court observed that if the clause deprives the debtor of its property – that which the debtor is entitled to but does not get – such a clause may contravene Article 20 Fw.[65] This is similar to the operation of the anti-deprivation rule under English law. The court stated that if the clause terminates the right to performance solely due to an insolvency event – with the result that the other party, which has already received the consideration for it, no longer needs to effectuate its own performance – such a clause may, depending on the context and other circumstances, be null and void. It also stressed that there is a possibility that invoking such a clause can be unacceptable in the given circumstances based on standards of reasonableness and fairness.[66] Yet these considerations did not apply to the case at hand, as the commission constituted the consideration for performance and benefits, which were lost as a result of Megapool's insolvency.[67] The trustees' claim failed in view of this interpretation. Nevertheless, the reasoning of the court

62 HR 12 April 2013, *NJ* 2013/224, *JOR* 2013/193, m.nt. J.J. van Hees (*Megapool/Laser*).
63 Dutch Civil Code, Article 3:40.
64 Dutch Civil Code, Article 6:248(2). H.N. Schelhaas, Redelijkheid en billijkheid (Monografieen BW), Wolters Kluwer, 2017.
65 Article 20 Fw establishes that "the bankruptcy includes the entire assets of the debtor at the time of the bankruptcy order, as well as what it acquires during the bankruptcy."
66 HR 12 April 2013 (*Megapool/Laser*), 3.4.2.
67 Ibid., at 3.4.4.

confirms that insolvency-triggered clauses in principle can be annulled if they deprive the debtor of its property or if they fail to meet standards of reasonableness and fairness – a demanding test to pass. Decisive are the circumstances of the case, including the context of the agreement and the purpose of the clause itself.[68]

The possibility to enforce ipso facto clauses under Dutch law has attracted some criticism in academic literature, particularly in view of its (likely) negative impact on debtors' chances of restructuring and the position of unsecured creditors.[69] The Explanatory Memorandum to the WHOA asserts that "[i]t is crucial for the survival of the company that [current] agreements are maintained, particularly where its business operations depend on certain contracts, such as those with suppliers, customers, employees and IT specialists."[70] The desire to preserve valuable contracts and promote corporate rescue was the driving force behind the adoption of the WHOA. Article 373(3) Fw provides that:

> The preparation and offering of a restructuring plan as referred to in Article 370(1), and the appointment of a plan expert as referred to in Article 371, as well as events and actions directly related to this or to the execution of the restructuring plan and reasonably necessary for that purpose, do not constitute grounds for amendment of obligations or undertakings towards the debtor, for the suspension of any obligation towards the debtor and for termination of an agreement concluded with the debtor.

The restrictions on the effects of ipso facto clauses introduced by the WHOA are substantial. First, unlike the US Bankruptcy Code and the UK's Insolvency Act 1986, Article 373(3) Fw applies to a wide range of agreements ("obligations or undertakings towards the debtor"), including loan agreements.

---

68 Rb. Midden-Nederland 11 March 2015, r.o. 4.23ff, *JOR* 2015/342 (*Van Dijk q.q./Reaal-Srlev*). F.M.J. Verstijlen, De betrekkelijke continuïteit van het contract binnen faillissement, in W.J.M. van Andel & F.M.J. Verstijlen, Materieel faillissementsrecht: de Peeters/Gatzenvordering en de overeenkomst binnen faillissement. Preadviezen 2006 uitgebracht voor de Vereniging voor Burgerlijk Recht, Kluwer: Deventer 2006; T.T. van Zanten, De overeenkomst in het insolventierecht (Recht en Praktijk, nr. InsR3), Deventer, Kluwer 2012.

69 T. van Zanten, Het lot van de overeenkomst bij insolventie: Stormachtige ontwikkelingen op het snijvlak van het overeenkomsten- en insolventierecht, TvI 2020/49, noting with respect to contractual clauses that aim to regulate a situation in which one of the parties to a contract becomes insolvent: "Although such clauses certainly do not always have to be based on improper motives, they should always be treated with scepticism. Such a clause is intended to mitigate the adverse consequences of insolvency for one party in some way, which will generally be at the expense of the recovery of the joint creditors." N.W.A. Tollenaar, Het pre-insolventieakkoord. Grondslagen en raamwerk (diss. Groningen), Deventer: Wolters Kluwer 2016, 8.2.7.1, observing that enforcing a termination clause may be to the "detriment of the creditors as a group, who have to watch with sadness how the contracting party withdraws the value of the contract from "the estate" without any real ground."

70 MvT, *Kamerstukken II* 2018/19, 35249, 3.

Second, the preparation or implementation of a WHOA scheme (also referred to as a WHOA plan or restructuring plan) cannot be relied upon as a ground to invoke Article 6:80 BW. This article covers a situation where, before the claim becomes due and payable, it is established that the debtor will most likely fail to duly perform an obligation.[71] In effect, the debtor may be regarded to be in default, although technically no default has yet occurred. The operation of Article 6:80 BW is comparable to that of the Anglo-American doctrine of "anticipatory breach of contract".

Third, an event with which an ipso facto clause associates the termination or amendment of a contract is understood to include the preparation and offering of a restructuring plan and "events and actions directly related to this or to the execution of the restructuring plan and reasonably necessary for that purpose." Given that the Dutch Bankruptcy Act refers to a restructuring plan, the unenforceability of ipso facto clauses seems to be solely reserved for procedures aiming at the adoption of such a restructuring plan – WHOA schemes. As a result, if an ipso facto clause is linked to an event unrelated to the WHOA scheme (e.g. the opening of a bankruptcy proceeding), the limitations on ipso facto clauses will not apply.

In this respect, Dutch law differs from US and UK law, both of which cover a wide range of insolvency procedures, including liquidation procedures. At the same time, even if the clause does not fall within the WHOA's anti-ipso facto regime, it can still be subject to scrutiny and be annulled if it deprives the debtor of its property or if its enforcement is unacceptable under the general standards of reasonableness and fairness.

The figure below summarises the main features of the regulation of ipso facto clauses in the chosen jurisdictions.

71 Asser/Sieburgh 6-I 2020/410.

Figure 7. Prohibition of ipso facto clauses in UK, US and Dutch law

	UK	USA	Netherlands
Procedures covered	Relevant insolvency procedures (e.g. moratorium, Part 26A plans, administration, CVA, liquidation) but excluding Part 26 schemes	All procedures under the US Bankruptcy Code	Explicitly only WHOA schemes, but potentially other procedures, if the enforcement is unacceptable under the standards of reasonableness and fairness
Contracts covered by the prohibition	Contract for the supply of goods or services	Executory contracts and unexpired leases	In principle, all obligations or undertakings towards the debtor
Contracts excluded from the prohibition	Most financial contracts, including loans, financial leases, swaps and provision of guarantees. The exclusion also applies to the specified categories of persons involved in financial services (e.g. depository & investment banks, insurers and investment firms	A wide range of financial contracts, including forward contracts, swaps, repos, as well as a contract to make a loan, extend other debt financing or financial accommodation	Financial framework agreements, such as ISDA Master Agreement and Global Master Repurchase Agreement and other arrangements involving close-out netting and financial collateral

9.3.4 International developments

The emergence of rules seeking to restrict the legal effects of ipso facto clauses has accompanied the enactment of new restructuring laws. Over the recent three decades, but especially during the last five years, an increasing number of jurisdictions reformed their laws and introduced limitations on ipso facto clauses to promote corporate rescue. Some of these jurisdictions are mentioned below.

Figure 8. Restriction of ipso facto clauses

Jurisdiction	Year	Law
Canada	1992, 2005, 2007, 2009[72]	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, Articles 68 and 71
Australia	2018	Corporations Act 2001, sec. 415D, 434J, 451E[73]
Singapore	2018	Insolvency, Restructuring and Dissolution Act 2018, sec. 440[74]
EU	2019	Restructuring Directive, Article 7(5)
UK	2020 (in force since 26 June 2020)	Corporate Insolvency and Governance Act 2020, adding sec. 223B to the Insolvency Act 1986 (some limitations for specific contracts applied earlier)
Netherlands	2020 (in force since 1 January 2021)	Act on Court Confirmation of Extrajudicial Restructuring Plans (WHOA), Article 373(3) Fw
Germany	2020 (in force since 1 January 2021)	Enterprise Stabilization and Restructuring Act (StaRUG), § 44[75]
Austria	2021 (in force since 17 July 2021)	Restructuring Regulation (*Restrukturierungsordnung* or ReO), §26(3)

72 The relevant provisions invalidating ipso facto clauses were adopted gradually. A. Ho, The Treatment of Ipso Facto Clauses in Canada, McGill Law Journal, Vol. 61, 2015, pp. 139-189. The CCAA was amended in 2009 to expressly embed protections against ipso facto clauses. Prior to 2009, Canadian courts approved such protections in initial orders granting the commencement of CCAA proceedings. A. Duggan et al., Canadian Bankruptcy and Insolvency Law: Cases, Text, and Materials, 3rd edn, Emond Montgomery Publications, 2015, p. 296.

73 Australian law introduces many exclusions from the rule against ipso facto clauses, some of which cover common commercial contracts. C. Symes and J. Harris, Be Careful What You Wish For! Evaluating the Ipso Facto Reforms, OBLB, 13 September 2019. *Rathner, in the matter of Citius Property Pty Ltd (Administrator Appointed)* [2023] FCA 26.

74 In Singapore, the restrictions on ipso facto clauses apply in specified proceedings, which do not include winding up or receivership – proceedings which are not concerned with rehabilitation of distressed companies. A number of "eligible financial contracts" are excluded from the ipso facto regime, including derivatives agreements, repos, contracts to borrow or lend securities or commodities and margin loans. See further, M. Tan, K. Han, A Comparative Look at the Ipso Facto Regime, Singapore Academy of Law, SAL Prac 1, 2021.

75 The limitation of ipso facto clauses was previously derived from § 119 InsO, which aims to protect the right of an IP to accept and reject executory contracts. See BGH, Urteil vom 15. November 2012, BGHZ 195, 348 = NJW 2013, 1159.

This trend toward the "deactivation" (or a temporary stay) of ipso facto clauses has been supported by standard-setting organisations, both in the area of corporate insolvency and bank resolution.[76] 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. Despite the fact that the same set of arguments is often used to rationalise constrains on ipso facto clauses, divergent legal regimes arose across jurisdictions. In countries like the UK and the USA, certain contracts or persons are explicitly carved out from the prohibition (e.g. financial contracts). In other countries (e.g. the Netherlands), the material scope of the prohibition is broader (i.e. loan agreements are not carved out), yet the scope may be limited by the types of procedures that trigger the prohibition (e.g. WHOA schemes).

9.4 Enforceability of Cross-Default Clauses in Insolvency

9.4.1 The UK: suspension of termination rights during "insolvency period"

The previous section dealt with ipso facto clauses, and we observed that an increasing number of jurisdictions prohibit or impose restrictions on their effectiveness. This section will discuss cross-default clauses. As noted above, the main difference between an ipso facto clause and a cross-default clause – as defined in this book – is that the latter is triggered by a default on a debt obligation or another type of misbehaviour. In practice, both types of clauses may facilitate insolvency,[77] including insolvency within an enterprise group. Both might be used as a bargaining tool to renegotiate contract terms.

In the previous section, it was highlighted that English courts have long accepted and enforced contractual clauses providing for termination or acceleration upon the occurrence of a certain event – an event of default. The same holds true for cross-default clauses. In *Rahman & Ors v. HSBC*

76 UNCITRAL Legislative Guide on Insolvency Law, Part 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, Key Attribute 4.3 and I-Annex 5: Temporary stay on early termination rights.

77 Wood argues that cross-defaults have an "inertia effect", so that "[if] everybody can accelerate, nobody can since this spells bankruptcy." P. Wood, International Loans, Bonds, Guarantees, Legal Opinions, Sweet & Maxwell, 2007, para. 6-013. For a similar argument, see L. Gullifer, J. Payne, Corporate Finance Law: Principles and Policy, 2nd edn, Hart Publishing, 2015, p. 213. See also N. Li, Y. Lou, F.P. Vasvari, Default clauses in debt contracts, Review of Accounting Studies, Vol. 20, 2015, p. 1610, pointing out that a cross-default clause "may have an unintended domino effect that could seriously weaken the borrower's financial position."

Bank Plc & Ors,[78] the court recognised the fairness of such clauses and found sound commercial reasons for their inclusion in the agreements.[79] The enforceability of cross-default clauses is in line with the protective attitude of English law towards parties' bargains. This is reflected, inter alia, in the resistance of courts to accept a duty to act in good faith as a general organising principle of law. Relatedly, English courts have repeatedly refused to restrict termination clauses by an implied duty of good faith, especially in contracts between sophisticated parties.[80] Given that prior to the CIGA (and in many cases, after the CIGA, e.g. for financial transactions), ipso facto clauses were held to be valid and enforceable, it is hardly surprising that cross-default clauses have also received legal approval. A cross-default clause is unrelated to insolvency if it is triggered by a failure to pay in time, even though insolvency and the failure to perform substantive obligations may be correlated. An insolvent or nearly insolvent entity is likely to default on at least some of its obligations. Besides, referring to the considerations of the court in *Belmont*, a cross-default clause would usually have a legitimate commercial basis.

The 2020 reforms restricted the effectiveness of ipso facto clauses with the goal of ensuring efficient restructuring. Hence, it is reasonable to examine whether the adoption of the CIGA has changed the approach of English law to cross-default clauses. Section 233B(4) provides that:

---

78 *Rahman & Ors v. HSBC Bank Plc & Ors* [2012] EWHC 11 (Ch) (17 January 2012). Gullifer and Payne note that the commercial reason of including a cross-default clause in a contract is that "a default in meeting the obligations to one creditor is a good advance warning of financial difficulty." L. Gullifer and J. Payne, Corporate Finance Law: Principles and Policy, 2nd edn, Hart Publishing, 2015, p. 214. For the same observation, see C. Wells and A. Doulai, Till default do us part: facility agreements and acceleration, Butterworths Journal of International Banking and Financial Law, October 2013, p. 573. Also, *Black Diamond Offshore Ltd v. Fomento de Construcciones y Contratas SA* [2015] 4 WLUK 236, holding that a reasonable person would be aware of the fact that a "default on one debt under a particular contract is capable of cross-defaulting other debts under other contracts, setting off a chain reaction."

79 E. Lomnicka, Credit and security, in Chitty on Contracts, Vol II: Specific Contracts, 33rd edn, Sweet & Maxwell, 2018, para. 39-275, noting with respect to cross-default clauses that while "it may be objected that it is unfair to the borrower that a lender should be entitled to require immediate repayment under a loan agreement where the borrower has fully performed all of his obligations under the agreement, there is no doubt that such a clause will be upheld in a commercial agreement." English courts have held that the effects of an acceleration clause cannot be regarded as penalty, since they do not increase the overall obligation. *The Angelic Star* [1988] 1 Lloyd's Rep. 122, 125, 127; *ZCCM Investments Holdings Plc v. Konkola Copper Mines Plc* [2017] EWHC 3288 (Comm), at 37.

80 *TSG Building Services Plc v. South Anglia Housing Limited* [2013] EWHC 1151 (TCC); *Monde Petroleum SA v. Westernzagros Ltd* [2016] EWHC 1472 (Comm); *TAQA Bratani Ltd v. Rockrose UKCS8 LLC 8* [2020] EWHC 58 (Comm). See M.G. Bridge, The Exercise of Contractual Discretion, Law Quarterly Review, Vol. 135, 2019, pp. 227-248.

> Where -
> (a) under a provision of a contract for the supply of goods or services to the company the supplier is entitled to terminate the contract or the supply because of an event occurring before the start of the insolvency period, and (b) the entitlement arises before the start of that period, the entitlement may not be exercised during that period.[81]

The termination right is thus suspended or "frozen" for the duration of the relevant procedure (e.g. administration, restructuring plan, liquidation). This interferes with contractual termination rights. Yet, as with ipso facto clauses, the limitation of freedom of contract does not extend to a wide range of financial contracts and financial institutions. Banks or other financiers are free to rely on a cross-default clause to terminate or accelerate a loan agreement. By contrast, non-financial suppliers of goods and services – mostly trade creditors – are not able to terminate a contract based on a cross-default if the event of default occurred pre-insolvency and the right to terminate was not exercised before the opening of the relevant procedure. However, if the default occurs after the commencement of such a procedure (e.g. non-payment for goods supplied after the opening of an insolvency proceeding), the law does not affect termination and other similar rights. In practice, the suspension of cross-default clauses during the insolvency procedure can incentivise creditors to exercise their termination rights as soon as signs of financial distress appear. This could be detrimental to the very goal of promoting restructuring, underpinning the CIGA.

The CIGA and English insolvency law generally do not establish a structured process in which the debtor or the trustee must decide within a specified time frame whether to assume, reject or assign an executory contract (as found in US law, see below). Neither does it law down an obligation to provide security for new obligations arising during the insolvency procedure (as found in Dutch law, see below). Instead, the law states that suppliers cannot condition any future supply of goods and services on the payment of outstanding charges for supplies made before the opening of the insolvency procedure.[82] Hence, suppliers cannot terminate the contract or demand payment for past debts as a condition for future supplies. There is an exception in cases of hardship, where the court may approve the

81 Insolvency Act 1986, Section 233B(4).
82 Insolvency Act 1986, Section 233B(7).

termination of a contract causing hardship.[83] Termination is also permitted with the consent of an office-holder.[84] The supplier should also be able to terminate the contract if a post-insolvency default occurs (e.g. non-payment of post-insolvency claims), giving rise to a new event of default. It is worth noting that financial creditors are excluded from the scope of these provisions, while trade creditors – often unsecured and facing the risk of losing all the value of their claims – are targeted. This different treatment is problematic and raises fairness concerns.[85]

9.4.2 The USA: contract assumption and de-acceleration

The right of a creditor to terminate a contract that is favourable to the debtor may go against the power of the debtor in possession or a trustee, appointed by the court, to assume or reject an executory contract. The US Bankruptcy Code states that "the trustee, subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor."[86] Under US law, the bankruptcy estate does not automatically become a party to an executory contract. This contract remains in limbo until a representative of the bankruptcy estate makes a decision whether to assume or reject it. If the debtor chooses to assume the contract, any outstanding defaults must be fully cured, and the counterparty must be provided with adequate assurances of continued performance. Any ongoing liabilities under the contract become payable with administrative priority, ensuring that the counterparty is likely to be kept whole.[87] If the contract is rejected, such rejection leads to a breach of contract, effective as of the petition date. As a result, the counterparty acquires a claim for damages against the debtor, which can be compromised in a reorganisation plan.[88] In essence, the debtor facing financial distress has a choice between continuing to perform under the contract or opting for a breach.

---

83 Insolvency Act 1986, Section 233B(5)(c). Reliance on the financial hardship exclusion may be difficult due to a high threshold. See further L. Hotton, J. Norris, UK Corporate Insolvency and Governance Act: effects on ipso facto clauses, Butterworths Journal of International Banking and Financial Law, September 2020, p. 552, noting that "[i]t is arguable that the measures go too far to the detriment of suppliers". A similar hardship provision can be found in Singapore (IRDA, sec. 440(4)). For the interpretation of "significant financial hardship" in the Canadian context, see *Toronto-Dominion Bank v. Ty (Canada) Inc*, 42 CBR (4th) 142, 2003 CanLII 43355.

84 Insolvency Act 1986, Section 233B(5)(a).

85 J. Sarra, J. Payne, S. Madaus, The Promise and Perils of Regulating Ipso Facto Clauses, International Insolvency Review, Vol. 31, 2022, p. 71.

86 11 U.S. Code § 365(a).

87 S. Paterson, A. Walters, Selective Corporate Restructuring Strategy, Modern Law Review, Vol. 86, 2023, p. 450.

88 *Mission Product Holdings, Inc. v. Tempnology, LLC*, 139 S.Ct. 1652, 1661 (U.S., 2019) ("Rejection of a contract – any contract – in bankruptcy operates not as a rescission but as a breach").

The right to assume an executory contract "preserves valuable contracts for the benefit of the estate."[89] Assumption is therefore usually a choice for the above-market contracts. This choice only applies to executory contracts. Non-executory contracts are regarded either as assets (constituting a debtor's claim against a third party) or liabilities (representing a debt owed to a third party), which must be disclosed together with other interests. They are not subject to assumption, rejection, or the ride-through doctrine.[90]

US bankruptcy law differentiates between defaulted and non-defaulted executory contracts. Thus, "[i]f there has been a default in an executory contract […] of the debtor, the trustee may not assume such contract or lease unless […] the trustee […] cures, or provides adequate assurance that the trustee will promptly cure, such default […]."[91] This rule applies only if there has been a default, whether pre- or post-petition, other than the insolvency-triggered (i.e. ipso facto) default.[92] It commits the estate to full performance under the contract, including curing any defaults, in exchange for the continuation of the counterparty's duties. The counterparty is provided with the benefit of its economic bargain and acquires an administrative priority claim against the estate on the assumed contract. Be it as it may, outside bankruptcy, the defaulted debtor might not be entitled to cure the default and "restore" a valuable contract. Why does bankruptcy law change this? Jackson suggests that the reason could be debtor passivity or debtor indifference – the debtor who knows that he is insolvent may not care about defaults and what happens with his assets.[93]

From the wording of the US Bankruptcy Code, it is not entirely clear whether, as a condition to assuming an executory contract with a cross-default clause, the debtor must cure a default of an obligation arising from another (separate) contract. If the cross-default provision is enforceable, the assumption of a valuable contract will depend on the performance under all contracts connected through a cross-default – a very demanding requirement. In the case of *United Air Lines, Inc., v. U.S. Bank Trust.*, the court permitted the assumption of a contract despite the default on another contract

89 E.J. Janger, J.A.E. Pottow, Implementing Symmetric Treatment of Financial Contracts in Bankruptcy and Bank Resolution, Brooklyn Journal of Corporate, Financial & Commercial Law, Vol. 10, 2015, p. 163.

90 *ASARCO, L.L.C. v. Montana Res., Inc.*, 858 F.3d 949, 959 (5th Cir. 2017), noting that "[e]xecutory contracts that are not assumed or rejected 'ride through' the bankruptcy unaffected by the bankruptcy proceedings." Thus, non-rejected prepetition executory contracts "ride though" the bankruptcy and continue to exist and be binding thereafter.

91 11 U.S. Code § 365(b). The law does not define "adequate assurance" and what constitutes such assurance will depend on the facts and circumstances of each case. *In re Patriot Place, Ltd.*, 486 B.R. 773, 801 (Bankr. W.D. Tex. 2013).

92 11 U.S. Code § 365(b)(2).

93 T.H. Jackson, The Logic and the Limits of Bankruptcy Law, HUP, 1986, p. 118.

linked to the first contract by a cross-default clause. Refusing to give effect to this clause, it noted that the policy underlying the US Bankruptcy Code was to assist in the debtor's rehabilitation or liquidation by permitting the assumption of valuable contracts. According to the court, this purpose:

> could certainly be frustrated if a debtor were required to perform under unrelated contracts as a condition for assumption. For example, a particular supplier of goods to the debtor might provide that its supply contract would terminate upon the debtor's breach of any similar agreement with other specified suppliers. Such a "pay all" requirement could effectively serve as a proxy for the debtor's insolvency, and, in bankruptcy, it would require the debtor to pay the pre-petition claims of the specified suppliers as a condition for assumption […]. However, the cross-default rule addresses this problem by preventing a debtor from being required to perform contracts substantially unrelated to the one sought to be assumed.[94]

Thus, even though cross-default clauses differ from ipso facto clauses, and unlike the latter, they are not invalidated by the express provisions of law, the court recognised that they may have similar effects and inhibit the debtor's restructuring. It explained that any other interpretation would allow the non-debtor party to impose on the estate "the costs of substantially unrelated agreements."[95] The notions of "substantial relation" or "economic interdependence" between separate agreements play an important role in determining whether a cross-default provision should be enforced.[96] In the earlier case of *In re Kopel*, it was established that courts refused to enforce cross-default clauses in cases where contracts were not interrelated. The court held that "where the non-debtor party would have been willing, absent the existence of the cross-defaulted agreement, to enter into a contract that the debtor wishes to assume, the cross-default provision should

---

94 *United Air Lines, Inc., v. U.S. Bank Trust, N.A.* 346 B.R. 456 (Bankr. N.D. Ill. 2006), denying the enforcement of a cross-default provision in the lease of airport terminal space and a separate agreement to make payments on certain bonds.

95 Ibid. For discussion of this case and the role of substantial connectedness, see A. Coles-Bjerre, Ipso Facto: The Pattern of Assumable Contracts in Bankruptcy, New Mexico Law Review, Vol. 40, 2010, p. 105, concluding that "courts have, in effect, extended the Code's invalidation of ipso facto clauses […] by invalidating cross-default clauses that bear an insufficient relationship to the contract that the debtor is seeking to assume." On the subject, see also A.N. Resnick, B.E. Scheler, From the Bankruptcy Courts: The Effect of a Cross-Default Provision on the Ability to Assume an Executory Contract or Unexpired Lease, Uniform Commercial Code Journal, Vol. 32, 2000, pp. 338-343.

96 See *Lifemark Hospitals, Inc. v. Liljeberg Enters. (In re Liljeberg Enters.)*, 304 F.3d 410 (5th Cir. 2002); *The Shaw Group, Inc. v. Bechtel Jacobs Co., LLC (In re The IT Group, Inc.)*, 350 B.R. 166 (Bankr. D.Del. 2006); *In re Szenda*, 406 B.R. 574, 581 (Bankr. D. Mass. 2009), holding that the agreements in question were not "part and parcel of the same bargain, regardless of the inclusion of the cross-default clause." *In re Kline*, 2013 WL 587339 (Bankr. D. Or. 2013), noting that the presence of cross-default provisions "is not enough in itself to integrate agreements that are otherwise separate or severable."

not be enforced."[97] It noted that such enforcement may be seen as a way to extract priority under an unrelated contract and maximise returns for a specific creditor.

There is an important exception to the assumption right; it does not cover executory contracts "to make a loan, or extend other debt financing or financial accommodations, to or for the benefit of the debtor, or to issue a security of the debtor."[98] This exception is aligned with the carve out from an ipso facto ban, discussed above. Both address a specific fear that a lender would be forced to extend new credit through the assumption by the debtor of a pre-petition financial agreement. Contracts to (i) make loans, (ii) extend debt financing, (iii) extend financial accommodations, or (iv) issue a security of the debtor are variations of the types of contracts that raise this concern.[99] Therefore, a lender under a revolving credit facility would not be forced to finance the bankrupt. Importantly, since the new credit benefits from the administrative priority status, the exception regarding the assumption of financial agreements protects the interests of the entire body of unsecured creditors. US courts strictly construe the scope of this exception and do not apply it to contracts involving the provision of goods or services that have incidental financial accommodations or extensions of credit.[100] However, they do classify surety bonds and guarantee agreements as "financial accommodations", thereby exonerating them from the assumption.[101] If the debtor wishes to attract cash to finance restructuring or extend security for such financing, it must comply with the special rules aimed at balancing the interests of different stakeholders in a bankruptcy case – DIP financing rules (see section 12.2.3.).[102]

---

97 *Kopel v. Campanile (In re Kopel)*, 232 B.R. 57, 66 (Bankr. E.D.N.Y. 1999).

98 11 U.S. Code § 365(c)(2).

99 See *In re Teligent, Inc.*, 268 B.R. 723 (Bankr. S.D.N.Y. 2001) for a detailed account of the Congress' intent behind 11 U.S. Code § 365(c)(2).

100 Courts have held that a credit card merchant agreement, letters of credit and a dealership agreement were not financial accommodations. See *In re United Airlines, Inc.*, 368 F.3d 720 (7th Cir. 2004); *Rafool v. Evans*, 497 B.R. 312 (C.D. Ill. 2003); *In re Jonesboro Tractor Sales, Inc.*, 619 B.R. 223 (Bankr. E.D. Ark. 2020).

101 *In re Wegner Farms Co.*, 49 B.R. 440 (Bankr. D. Iowa 1985); *In re Thomas B. Hamilton Co., Inc.* 969 F.2d 1013, 1019 (11th Cir. 1992) ("courts have held that loan commitments, guaranty and surety contracts, and other contracts the principle purpose of which is to extend financing to or guarantee the financial obligations of the debtor are contracts to extend financial accommodations."). Also, *In re Falcon V, LLC*, 620 B.R. 256 (Bankr. M.D. La. 2020).

102 11 U.S. Code § 364, governing post-petition extension of credit, providing for specific incentives and safeguards. Given the special framework for post-petition financing, courts have ruled that loan agreements are non-assumable even if the lender has "voluntarily" consented to make a post-petition extension of credit. *In re Cardinal Industries, Inc.*, 146 B.R. 720 (Bankr. S.D. Ohio 1992); *In re Sun Runner Marine, Inc.*, 945 F.2d 1089, 1093 (9th Cir.1991), holding that § 365(c)(2) unambiguously prohibits the assumption of financial accommodation contracts, regardless of the consent of the non-debtor party.

Nevertheless, the US Bankruptcy Code contains special rules that permit a plan to reverse a contract acceleration – contract de-acceleration, including with respect to a loan agreement. As a background, US law allows the debtor to leave a class of creditors out. Creditors in such an unimpaired class are presumed to have accepted the reorganisation plan.[103] A class of claims is treated as unimpaired if the plan, irrespective of any contractual provision that entitles the holder of a claim to demand or receive accelerated payment of such claim after the occurrence of a default, (i) cures any such default (other than a default caused by an ipso facto clause that needs no cure), (ii) reinstates the maturity of a claim as it existed before the default, and (iii) compensates the claim holder for damages incurred as a result of any reasonable reliance by such holder on this contractual provision.[104]

This provision creates a powerful weapon that allows a Chapter 11 plan to de-accelerate and reinstate a pre-petition obligation – a technique sometimes referred to as "cram-up". It permits the debtor to cure any defaults, whether pre- or post-petition, nullifying any consequences of these defaults and returning the parties to pre-default conditions. This applies even if a senior creditor has obtained a foreclosure judgment, but the collateral has not yet been sold. As a result, the debtor is relieved of the burdens of contract acceleration clauses and can maintain the original terms. At the same time, the creditor receives the benefit of his original bargain.

Thus, while the trustee, debtor in possession, or a reorganisation plan cannot assume a loan contract and force the lender to continue financing the debtor (new credit), the plan could de-accelerate the granted loan. Consequently, it may prevent "a party from using a contractual right of acceleration to terminate a valuable contract of the debtor in circumstances where the debtor is willing to cure past defaults and perform under the original terms of the agreement."[105] The question is whether "curing any defaults" includes cross-defaults. In this respect, in view of the courts' attitude to cross-default clauses in the assumption context, a similar approach is warranted in the de-acceleration context. If contracts are not substantially connected and are not economically interdependent, the debtor should not be required to cure all cross-defaulted contracts in order to de-accelerate the loan. Any other solution could render the de-acceleration right illusory. That said, the case law on this issue is rather limited. This may be explained by

103 11 U.S. Code § 1126(f).
104 11 U.S. Code § 1124(2).
105 Collier on Bankruptcy, 16th edn, 2022, Vol. 7, ¶ 1124.04[5].

the limited appeal of de-acceleration,[106] creditors' unwillingness to enforce cross-defaults and risk their reputation, and the proliferation of covenant-light loans.[107]

In sum, under US law, cross-default clauses are not per se invalid. However, they are inherently suspect due to their potential to hamper a debtor's reorganisation.[108] Courts carefully scrutinise the facts and circumstances of relevant agreements. This scrutiny is especially relevant in the context of assumption and de-acceleration of contracts, which are subject to the requirement of curing any defaults, except ipso facto defaults. If the cross-defaulted contracts form a single, integrated or indivisible transaction, there are good reasons to enforce a cross-default clause, since doing otherwise would be contrary to the parties' legitimate expectations and their economic interests. Yet if the cross-defaulted contracts are not interrelated and economically interdependent, courts may refuse to enforce a cross-default clause.

9.4.3 The Netherlands: suspension of termination rights during "cooling-off period"

The right of parties to include a cross-default clause in their contract is based on the principle of freedom of contract. Generally, Dutch law of obligations (*verbintenissenrecht*) is dispositive (*aanvullend recht*) and not imperative law (*dwingend recht*).[109] Therefore, unless law mandates otherwise, parties are free to shape their relations as they wish. This also means that parties are free to deviate from statutory regulation of defaults (e.g. when it comes to a notice of default).[110] While cross-default clauses are generally considered to be enforceable, their enforceability may be limited by mandatory rules, such as those introduced by the WHOA. According to Article 373(4) Fw,

> If a cooling-off period has been ordered in accordance with Article 376, during that period, any default by the debtor that has occurred prior to the cooling-off period does not constitute a ground for the amendment of any commitment or obligation in respect to the debtor, for the suspension of the performance of any commitment in respect of the debtor, or for the termination of any contract concluded with the debtor to the extent that security has been provided for the performance of new obligations arising during the cooling-off period.

106 T.H. Jackson, The Logic and Limits of Bankruptcy Law, Beard Books, 2001, p. 37, noting that a de-acceleration right "is likely to be exercised principally against secured creditors with below-market loans".

107 A.J. Casey, The New Corporate Web: Tailored Entity Partitions and Creditors' Selective Enforcement, The Yale Law Journal, Vol. 124, 2015, p. 2680.

108 *In re Cumberland Corral, LLC*, 2014 Bankr. LEXIS 936 (Bankr. M.D. Tenn. Mar. 11, 2014).

109 Asser/Sieburgh 6-III 2022/316; M.A. Loth, Dwingend en aanvullend recht (Mon. BW A19), Wolters Kluwer, 2009.

110 Asser/Sieburgh 6-I 2020/387.

The reorganisation value, also referred to as a *going concern* surplus, may diminish if normal business operations come under pressure in connection with the restructuring. Article 373(4) Fw addresses a situation where a party to an agreement refuses to continue relations with the debtor due to a default. It aims, on the one hand, to guarantee that the goal of a cooling-off (a stay) is not frustrated, and on the other hand, to ensure that the interests of a counterparty that has already been confronted with a debtor's default are sufficiently safeguarded.[111] Unlike ipso facto clauses, which are inoperative, default-triggered clauses are valid, but their effectiveness is suspended or "frozen" during the cooling-off period – four months with a possible extension of no more than four months – a total of eight months.[112] The language of the discussed provision is broad enough ("any default by the debtor") to encompass cross-defaults. The following paragraphs summarise the key features of Dutch law in this respect.

First, unlike section 233B(4) of the Insolvency Act 1986, which has limited material scope, Article 373(4) Fw is broad in scope and captures almost all agreements, including loan agreements. One of the exceptions covers financial framework agreements, such as the ISDA Master Agreement and the Global Master Repurchase Agreement (GMRA). Although the original text of the WHOA does not make this exception explicit, during the legislative process,[113] it was clarified that if protection offered by close-out netting and security over financial collateral is diminished, the court shall grant the counterparty leave to enforce security over financial collateral provided under a financial collateral arrangement.[114] The Act Transposing the Restructuring Directive in the Netherlands (in force since 1 January 2023) clearly excludes these agreements from the WHOA's scope and, therefore, from its limitations on the enforceability of certain contract terms.[115]

---

111 This balance is in line with Article 7(4) of the Restructuring Directive, which aims to strike a balance between restricting parties' termination and acceleration rights related to a default, on the one hand, and preventing unfair prejudice caused to such creditors as a result of the imposed restriction, on the other hand.

112 Article 376 Fw. For a similar rule, see StaRUG, Article 55(1).

113 *Kamerstukken I* 2019/20, 35 249, C (MvA) p. 7-11.

114 Nijkamp and Steeg argue that the need to obtain leave from a court may be inconsistent with Article 4(4)(d) and 4(5) of the Financial Collateral Directive and with Article 241d Fw. D.D. Nijkamp and R.W.K. Steeg, How certain elements of the Dutch scheme may (or may not) affect ISDA Master Agreements, FIP, No. 1, 2021, p. 55; S. Renssen, De herijking van het faillissementsrecht. De WHOA (Recht & Praktijk, nr. InsR17), Deventer: Wolters Kluwer 2021. On the ISDA Master Agreement, see W.A.K. Rank, Een paarlen jubileum voor de ISDA Master Agreement: 30 jaar contractszekerheid voor OTC-derivaten, *FR*, afl. 4, 2017, p. 117-128.

115 Implementatiewet richtlijn herstructurering en insolventie (Stb. 2022, 491); Besluit van 5 december 2022 tot vaststelling van het tijdstip van inwerkingtreding van de Implementatiewet richtlijn herstructurering en insolventie (Stb. 2022, 492), making amendments to Article 369 Fw.

Second, the Dutch Bankruptcy Act distinguishes between a default that occurred before the cooling-off period (*afkoelingsperiode*)[116] and a default that took place thereafter. Notably, the Act Transposing the Restructuring Directive clarifies that the timing of the default – before or during the cooling-off period – is not important. What matters is whether the default relates to a pre-cooling-off period commitment. Only this default is covered by Article 373(4) Fw, which aims to facilitate negotiations over a restructuring plan and supports the debtor's operation during such negotiations. If the debtor defaults on new, post-cooling-off period obligations, the creditor can rely on the contract to amend, suspend or terminate it. This does not mean that the creditor is entitled to enforce his claim; the enforcement is stayed during a cooling-off period (Article 376 Fw).

Figure 9. Limitations concerning (cross-)defaults in UK, US and Dutch law

	UK	**USA**		**Netherlands**
Relevant limitation	Suspension of termination rights during the insolvency period	Assumption	De-acceleration	Suspension of termination and amendment rights during a cooling-off period
Contracts covered	Contracts for the supply of goods or services, unless the counterparty is a person involved in financial services (e.g. a bank)	Executory contracts and unexpired leases, unless exempt (e.g. contract to make a loan or extend other debt financing)	All contracts (e.g. including loan agreements), unless exempt (e.g. qualified financial contracts)	Any commitment or obligation, unless exempt (e.g. financial framework agreements)
Special conditions applied	N/A. Termination possible in case of hardship or with consent of an office holder	Cure any defaults, compensate for any actual pecuniary loss, adequate assurance of future performance	Cure any defaults, reinstate maturity of a claim, compensate any damages	Security for new obligations, arising during a cooling-off period
Cross-defaults covered	Yes	Yes, if relevant obligations are interrelated and economically interdependent		Yes

116 A cooling-off period is similar to a stay. For discussion of insolvency stays, see Chapter 11 of the book.

Third, protection against default-triggered contract termination or alteration is premised on the obligation to provide security for the performance of new obligations under the contract, arising during the cooling-off period.[117] This requirement can be met, inter alia, by immediate fulfilment of these obligations (cash on delivery).[118] Insofar as security is insufficient, the creditor's right to amend or terminate the contract or to suspend performance under it does not lapse. When compared to US law, Dutch law (just like English law) does not mandate that the pre-cooling-off defaults are cured for the remaining obligations to stay in force. Therefore, the problem of the "pay all" commitment under substantially unrelated agreements, existing in the USA, is avoided.

To sum up, the Dutch Bankruptcy Act "freezes" the enforceability of (cross-) default clauses for the duration of a cooling-off period. What happens after its expiration? Given that default-triggered termination rights are valid and only temporarily suspended, upon the expiration of a cooling-off period, the protection of 373(4) Fw ceases.[119] This means that a default may "survive" the WHOA scheme and should be addressed when negotiating and voting on it.

9.5 Insolvency and Ex-post Effects of Ipso Facto and Cross-Default Clauses in a Group Context

In Chapter 6, we stressed that intercompany guarantees increase group interdependence and interconnectedness. We also mentioned that they may complicate group restructuring. Similar observations can be made regarding ipso facto and cross-default clauses, which connect different companies within the same enterprise group.

Just like cross-guarantees, cross-entity ipso facto and cross-default clauses impose correlation between separate legal entities and increase their dependence on the performance of the whole group. Imagine that a creditor is entitled to terminate or accelerate a contract with Company A for the sole reason that Company B becomes financially distressed or files for insolvency, or defaults on its obligation to someone else. The activation of ipso facto and cross-default clauses could create a chain reaction, negatively impacting Company A and potentially the entire enterprise. In other words, contractually-created correlation can quickly escalate into a group-wide contagion – the infamous domino effect. As a result of contract acceleration attributed to a cross-default, Company A may become unable to perform unrelated obligations owed to other parties. Similarly, reliance on an ipso

117 MvT, *Kamerstukken II* 2018/19, 35249, 3.

118 R. van den Sigtenhorst, in: T&C Insolventierecht, commentaar op art. 373 Fw. For a similar provision in German law, see StaRUG, section 55(3).

119 Ibid. (Sigtenhorst).

facto clause to invoke the amendment, acceleration or termination of a contract can increase liquidity pressure, lead to defaults and cross-defaults on various obligations, and even destroy the prospects of successful restructuring.[120] In practice, the willingness of a creditor to pull the trigger and terminate or accelerate the contract, or abstain from the enforcement and agree to new contract terms (e.g. extension of maturity dates) may depend on multiple factors. Among them are the likely spread of contagion across the enterprise group, the existence of a security interest benefiting the creditor, reputational concerns, the viability of the group's business, trust in the debtor's management, information availability and wider market dynamics and competitive pressures.

The threat of ipso facto and cross-default clauses weakens the negotiation power of the debtor and may encourage holdout behaviour by a counterparty – a creditor that can rely on a cross-default or ipso facto clause. Importantly, the risk of termination of a valuable contract, arising from the exercise of a contractual right, is capable of deterring the debtor from seeking formal restructuring and early help.[121] The debtor or its affiliate may postpone debt restructuring due to the risk of causing a group-wide enforcement. As a result, the management of the debtor or of another group entity, linked to the debtor through a contract clause, may be reluctant to take early steps to address financial difficulties and prevent insolvency.

9.6 Conclusion

This chapter examines two types of clauses, which are prevalent in financial transactions, such as syndicated loan, bond, derivatives, repos and securities lending documentation – ipso facto and cross-default clauses. These clauses often connect several entities within an enterprise group. For example, an "event of default" that permits the creditor to amend, terminate or accelerate the contract may refer to a fact or occurrence relating to another group member (e.g. insolvency filing, default on a payment obligation).

As for the rationale and ex post effects of ipso facto and cross-default clauses, they serve risk control and risk mitigation functions. They may seek to deter a breach (given the gravity of its consequences), discipline

120 F. 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, p. 24, 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."

121 B. Wessels, S. Madaus, Rescue of Business in Insolvency Law. Instrument of the European Law Institute, 2017, p. 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."

the debtor and other group companies, and allow the creditor to terminate, accelerate or withhold future performance upon the first signs of financial distress, thereby responding to increased counterparty risk and contributing to loss reduction. When supplemented by information covenants, they could improve overall creditor oversight and provide the creditor with additional leverage in negotiations with the debtor or a group of debtors. These are all valid commercial reasons that should be taken seriously. Besides, since in large-scale commercial lending and other financial contracts, parties tend to have equal bargaining power, no concerns about unfairness of contract terms arise. However, the ex post effects of ipso facto and cross-default clauses are troubling. It has been shown that their enforcement might result in the loss of value, should a valuable contract be terminated or accelerated. They reduce the bargaining power of the debtor, discourage early crisis responses and complicate restructuring efforts. In a group context, they can also contribute to the spread of contagion within the group.

The issue at stake is freedom of contract and its potential conflict with the goals of insolvency law. A creditor has contracted for an option to terminate, amend, or accelerate a contract. One can argue that the creditor (similar to a secured creditor acquiring a security interest) has already paid for this option when agreeing to contract terms. The question therefore is whether and under which circumstances limiting party autonomy is justified. From an overview of English, US and Dutch law (and briefly considering other legal systems), a general observation can be made that in recent years, freedom of contract has been increasingly curtailed to serve the principles of insolvency law, specifically estate value preservation and maximisation, and equal treatment of creditors. Even jurisdictions that have historically been the bastions of freedom of contract and offered limited tools to support full-scale financial and operational reorganisation (e.g. the UK) have introduced restrictions on ipso facto and (cross-)default-triggered clauses.

The very normative foundation of insolvency law is centred around limiting individual freedom for the benefit of creditors as a class and in the public interest.[122] This chapter demonstrates that many legal systems impose substantial restrictions on ipso facto clauses – provisions that entitle a creditor to unilaterally terminate, amend or accelerate the contract and refuse future performance due to the debtor's insolvency filing, its deteriorating financial condition, or another insolvency-linked event. Such interference with party autonomy is typically explained by the desire to advance

122 T.H. Jackson, Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain, The Yale Law Journal, Vol. 91, 1982, p. 862, noting that in the absence of a collective system, creditors would act out of immediate self-interest and engage in a race to use individualistic remedies, "even though it is not in the creditors' collective interest to use them at all." Also H. Rajak, Insolvency Law: Theory and Practice, Sweet & Maxwell, 1993, p. 86.

restructuring or the need to protect the going concern value of the debtor's business.[123] As Jackson points out, these clauses destroy "the collective weal in bankruptcy".[124]

The scope of restrictions varies from one country to another and may depend on the type of proceeding or contract (see figure 7). The prohibition of ipso facto clauses in the UK applies to most insolvency procedures but altogether excludes financial contracts, including loans and the provision of guarantees. Similarly, the US bankruptcy law's ban on ipso facto clauses does not apply to many financial contracts, including a contract to make a loan. Dutch law does not carve out loan agreements from the limitations on the enforceability of ipso facto clauses but is rather restrictive in terms of the procedures explicitly covered (i.e. WHOA schemes only).

Another observation to be made is that cross-default clauses triggered by a default on an obligation are treated differently from ipso facto clauses. They are generally held to be valid, as they do not fall under the ipso facto clause ban. However, some less far-reaching limitations may still apply to them (see figure 9). For example, both English and Dutch law suspend a default-triggered termination right for the duration of an insolvency proceeding and a cooling-off period, respectively. In principle, this limitation applies to cross-defaults. Yet, as with ipso facto clauses, English law does not touch termination rights in most financial contracts.

In contrast to English and Dutch law, US bankruptcy law offers a well-structured process for termination, assumption, and de-acceleration of contracts in bankruptcy. It grants special rights to the trustee or debtor in possession to assume an executory contract – a contract in which both parties continue to have ongoing obligations to each another, subject to the cure requirement. The assumption right does not extend to many financial contracts, including a contract to make a loan or extend other debt financing. Hence, financing obligations cannot be assumed, and a financier (e.g. a bank) cannot be forced to finance the bankrupt company, even if any default is cured. Nevertheless, the debtor can de-accelerate a defaulted loan agreement, provided that all defaults are cured. This de-acceleration option is attractive and is likely to be exercised to preserve the below-market loans, as ultimately the reinstated loan must be repaid in full. The question arises whether all cross-defaults should be cured before the debtor can assume or reinstate the contract. In this respect, US courts have considered cross-default clauses to be "inherently suspect". They did not require debtors to cure cross-defaulted contracts if such contracts were not interrelated and economically interdependent.

123 J. Sarra, J. Payne and S. Madaus, The Promise and Perils of Regulating Ipso Facto Clauses, International Insolvency Review, Vol. 31, 2022, p. 67.

124 See T.H. Jackson, The Logic and Limits of Bankruptcy Law, Beard Books, 2001, p. 43.

Part V

Group-sensitive Insolvency Law: Tools and Solutions

10 Group Debt Deleveraging and Debt Adjustment: Third-party Releases▪

10.1 Introduction

This part explores various "tools and solutions" for the specific concerns or problems discussed in the preceding part of the book. This is not to say that the legal instruments (e.g. transaction avoidance, statutory subordination of intra-group claims), transactions (e.g. cross-guarantees, intra-group loans), or contractual clauses (e.g. cross-entity ipso facto and cross-default clauses) are problems themselves. In fact, they often pursue legitimate goals, and are value-creating and beneficial. For example, as noted in Chapter 8, transaction avoidance rules serve an important purpose of maximising estate value and ensuring equal treatment of creditors. When viewed from this perspective, transaction avoidance itself becomes a solution to the problem of fraudulent and undervalued transactions, and unfair preferences. Similarly, typical group-related transactions, such as cross-guarantees and intra-group loans, may contribute to the efficient attraction and allocation of funds within an enterprise group, thereby facilitating the creation of value. Yet, as mentioned before, the explored legal instruments, transactions, and contractual clauses can create or exacerbate "problems" in a group insolvency context.

For instance, Chapter 8 discussed the problematic application of transaction avoidance law to transactions involving group entities. It was observed that frequently transactions, like group guarantees, are driven by group considerations or group interest. As a consequence, there may be no direct benefit for a group entity providing a guarantee. In view of legal separateness, recognising indirect benefits and determining the true economic effect a cross-guarantee could be challenging and might result in legal uncertainty. But let's assume that this transaction withstands legal scrutiny and is considered valid and enforceable – meaning it is not void *ab initio* and is not nullified upon the successful invocation of avoidance rules. In

---

▪ This chapter builds upon the following previously published work by the author:
- I. Kokorin, S. Madaus and I. Mevorach, Global Competition in Cross-Border Restructuring and Recognition of Centralized Group Solutions, Texas International Law Journal, Vol. 56, 2021, pp. 109-154.
- I. Kokorin, The Rise of "Group Solution" in Insolvency Law and Bank Resolution, European Business Organization Law Review, Vol. 22, 2021, pp. 781-811.
- I. Kokorin, Third-Party Releases in Insolvency of Multinational Enterprise Groups, European Company and Financial Law Review, Vol. 18, 2021, pp. 107-140.

such a case, the group guarantee is likely to affect the dynamics of group insolvency and restructuring. The exact ways in which this could happen were outlined in Chapter 6, dealing with various ex ante and ex post effects of cross-guarantees.

This chapter covers the response to the insolvency-related (ex post) effects produced by cross-guarantees and similar cross-entity liability arrangements. Given the group interconnectedness and synergies, as well as the complexities created by the triangle of rights and liabilities (principal debtor – creditor – group guarantor), more and more jurisdictions are adopting rules that provide for the possibility to restructure obligations of third parties, like group guarantors, through a single proceeding opened with respect to one group entity ("anchor" debtor[1]). Such restructuring is made possible via so called "third-party releases". In this chapter, we analyse this novel legal instrument or tool, which can be used to deleverage or adjust the debt of several group entities.[2]

This chapter proceeds as follows. Section 10.2.1. studies the rationale of third-party releases. It is followed by a comparative analysis, examining the availability of and conditions for third-party releases in three core jurisdictions: the UK (section 10.2.2.), the USA (section 10.2.3.) and the Netherlands (section 10.2.4.). This analysis reveals that the countries, and even courts within the same country (e.g. USA), adopt divergent views on the availability and desirability of third-party releases, not least because of their substantial effects on creditors' rights in the absence of certain bankruptcy law safeguards. Section 10.3. concludes with a summary of the main findings and a proposal of elements or considerations that may guide the design and application of rules on third-party releases.

10.2 Third-Party Releases

10.2.1 Rationale of third-party releases

As follows from Chapter 6, most commonly, insolvency of the principal debtor does not affect the rights of creditors against group guarantors, co-debtors and collateral providers. If it were, the protective function of these contractual arrangements would be undermined.

1 The term "anchor debtor" is borrowed from G. Ray Warner and M. Veder, Enterprise Group Restructuring: Dutch Options and United States Enforcement, European Insolvency and Restructuring Journal, 2021-7, 2021, pp. 1-52.

2 Different considerations might apply to third-party releases outside the enterprise group context. These non-group instances include, inter alia, releases of insurance companies, directors, legal and financial advisors, and tortfeasors in mass tort litigation. These cases often raise distinct legal and moral questions and touch upon different policy reasons. Therefore, they fall outside the scope of this book.

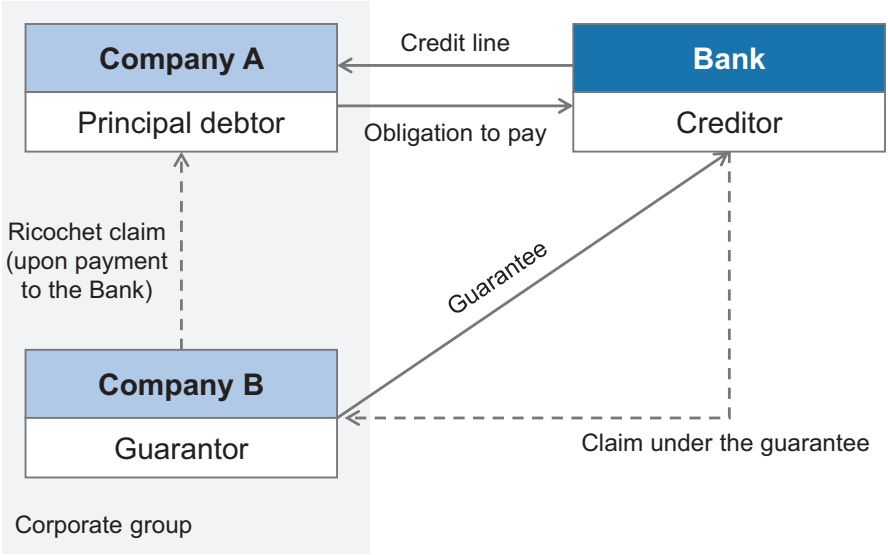

Figure 10. Triangle of rights and liabilities in group financing

Imagine that Company A initiates insolvency or restructuring proceedings, in which the claim of the Bank is altered. The fact that a claim of the Bank against the principal debtor (Company A) has been reduced or completely written down in a non-consensual way shall generally not affect the Bank's rights under the guarantee.[3] Yet this is not the end of our consideration.

In integrated groups, where the fates of group entities are intertwined or closely tied together, successful restructuring of a group entity often requires the preservation of group synergies and the survival of other group members. A debtor may need their assistance to both implement the reorganisation plan and to continue its operational activity in the wake of restructuring. The American Bankruptcy Institute recognised that such assistance could take the form of "service, collaboration, funding, business commitments, or other means that allow the debtor to achieve its objectives in the chapter 11 case or in its postconfirmation operations."[4] Be it as it may,

3 A situation is different if the creditor voluntarily discharges the principal debtor of its liability (workout). In this case, because of the accessory nature of a guarantee or suretyship, the corresponding liability of a guarantor could be discharged or reduced accordingly. See section 6.5.2.

4 ABI Commission to Study the Reform of Chapter 11, Final Report and Recommendations (ABI Commission), 2014, p. 255.

third parties acting as guarantors, co-debtors and collateral providers[5] can be reluctant to contribute to the restructuring plan or extend assistance thereafter if they remain exposed to creditor claims and are liable despite the confirmation of the debtor's restructuring plan. They might also be forced into insolvent liquidation or end up being sold to a competitor. This can have a significant effect on the economic viability of the anchor debtor. This debtor may end up failing in the future – a situation referred to as the "orphan restructuring problem". Therefore, a single-entity-focused restructuring without due consideration of the group reality, position and interests of group members risks being short-lived and inefficient.

Of course, a guarantor can initiate its own proceeding. However, this creates coordination and other transaction costs, especially if parallel proceedings are opened in different countries. Oi Brazil is a perfect demonstration of this (section 1.1.3.). The multiplication of proceedings is a cumbersome, costly and time-consuming solution. In addition to the redundancy of multiple proceedings, Veder and Thery argue that the duplication of proceedings gives an additional opportunity to dissenting creditors to exercise their holdout leverage, "if only it were for the litigation risk, costs and timing associated with the remedies available in the second proceedings."[6] Coordinated distress resolution within an enterprise group, especially where the group is international, is promoted by procedural centralisation. Such centralisation entails the concentration of separate insolvency proceedings in a single forum or in one court. It also manifests itself in situations where obligations of several group entities are restructured in a single proceeding opened with respect to one of them.

Over recent decades, restructuring liability within enterprise groups has increasingly been implemented via plans that approve third-party releases, allowing the resolution of claims against the principal debtor and its affiliates acting as guarantors, co-debtors, and collateral providers. In essence, a third-party release extends the legal effect of debt restructuring and responds to the complexities of group financing by sanctioning a single group-wide solution. Historically, third-party releases have been available

5 In the US literature and case law, such third parties are referred to as "nondebtors". See e.g. ABI Commission, p. 253. This term may be confusing since these parties owe the creditor and are, in a sense, debtors, although not always the principal ones (e.g. surety). Nevertheless, the term "nondebtor" can still be useful to signal that such a person is not subject to an insolvency or restructuring proceeding of its own.

6 M. Veder, A. Thery, The release of third party guarantees in pre-insolvency restructuring plans, in D. Faber, B. Schuijling and N. Vermunt (eds), Trust and Good Faith across Borders, Liber Amicorum Prof. Dr. S.C.J.J. Kortmann, Wolters Kluwer, 2017.

in common law jurisdictions, such as Australia,[7] Canada,[8] Singapore,[9] Ireland,[10] the Cayman Islands[11] and the UK. More recently, however, the tool of third-party releases was incorporated in civil law jurisdictions, including the Netherlands and Germany.

10.2.2 The UK: third-party releases in schemes of arrangement

English schemes of arrangement require some "give and take" on each side, as opposed to mere surrender or forfeiture.[12] The question is whether this "give and take" and the underlying arrangement are only available to the principal debtor and its creditors or can also extend to third parties. In *Re T&N Ltd.* the court ruled for the latter.[13] The case was decided under the Companies Act 1985 (sec. 425) and concerned actual and potential claims of employees and former employees of T&N Limited and 57 associated companies (debtors) for damages due to personal injuries from exposure to asbestos. Under the scheme, the debtors and employees (claimants) agreed not to assert their claims against liability insurers, on the condition that the insurers would establish a fund of £36.74 million to be held in trust to pay the damages whenever they are established. It was objected that the proposed scheme did not constitute an arrangement between T&N Limited and its creditors but instead represented a compromise between the debtors and insurers since the scheme did not compromise the rights of claimants against the scheme companies. The court dismissed this objection and affirmed the scheme. It held that the term "arrangement" had a broad meaning, which encompassed a settlement of litigation between T&N Limited and insurers to the extent that the settlement ("not immediately") affected the position of the debtors and was effectively a "tripartite matter". According to the court, the scheme was "an integral part of a single proposal affecting all the parties."[14]

This wide interpretation of the scope of schemes of arrangement was affirmed in *Re Lehman Brothers International (Europe)*, where the court noted that it was "entirely logical" to extend the jurisdiction to approve a scheme that varies or releases creditors' claims against both the principal debtor

---

7 *Re Opes Prime Stockbroking Ltd* [2009] FCA 813; *Re Tiger Resources Ltd.* [2019] FCA 2186.

8 *ATB Financial v. Metcalfe & Mansfield Alternative Investments II Corp.*, 2008 ONCA 587 (Ont. C.A.).

9 *Pathfinder Strategic Credit LP v. Empire Capital Resources PTE Ltd.* [2019] SGCA 29.

10 *In the matter of Nordic Aviation Capital Designated Activity Company* [2020] No. 162 COS.

11 *Re Sphinx Group of Companies*, Grand Court of the Cayman Islands, unreported, 5 May 2010.

12 *Re NFU Development Trust Ltd* [1972] 1 WLR 1548; *Re Lehman Brothers International (Europe) (in admin.)* [2018] EWHC 1980 (Ch); [2019] B.C.C. 115, at 64.

13 *Re T&N Ltd. (No. 3)* [2006] EWHC 1447 (Ch).

14 Ibid., at 52.

and third parties "designed to recover the same loss."[15] Claims subject to a release can be contractual or tortious in nature, as in the T&N case, and can be secured or unsecured. Importantly, the English court ruled that the release of a third party should be ancillary to the arrangement between the principal debtor and its own creditors, and that such a release must be "necessary in order to give effect" to the arrangement. This "necessity" requirement has come to be referred to as the "*Lehman* necessity".[16] Another qualification added by the court was that the rights of creditors against third parties should be closely connected with their rights against the principal debtor. On this point, the court highlighted that "the decision in T&N Ltd (No. 3) [was] near the outer limits of the scope of s. 895."[17]

A more recent case, *Far East Capital Limited*,[18] involved a discharge of obligations under two sets of notes in return for a payment by the debtor of a settlement amount. The scheme included the release of third parties – group entities that provided guarantees and security for the notes. Additionally, the release was given to other identified "protected parties" who had been involved in the preparation, negotiation, or implementation of the scheme. In *Van Gansewinkel Groep BV and others*, the court held that a release should be "necessary to give legal or commercial effect to the compromise or arrangement between the scheme company and its creditors."[19] The case concerned the release of group members under guarantees. In *La Seda De Barcelona*,[20] the court sanctioned a scheme that provided for the release of a third-party – group member Artenius under the guarantee agreement, in exchange for Artenius releasing other group members of its own claims. Thus, the release of Artenius benefited the scheme creditors because its release of the debtor and other group companies improved their financial position. In the alternative scenario, Artenius' claims could have triggered "insolvency of a company which would have escalated group bankruptcy proceedings."[21]

In *Noble Group Limited*,[22] the scheme was part of a complex group restructuring where, in return for writing off creditors' claims, the creditors received debt instruments issued by the newly incorporated companies. Additionally, the scheme entailed the release of claims against the debtor's man-

15 *Lehman Brothers International (Europe), Re Insolvency Act 1986* [2009] EWCA Civ 1161, at 63.
16 *Re Gategroup Guarantee Limited* [2021] EWHC 304 (Ch), at 163, noting that "[w]here the alteration of creditors' rights against third parties is both ancillary to the arrangement between the company and its creditors and necessary to ensure the effectiveness of that arrangement, then they will be permitted."
17 *Lehman Brothers International (Europe), Re Insolvency Act 1986* [2009] EWCA Civ 1161, at 83.
18 *In the matter of Far East Capital Limited S.A.* [2017] EWHC 2878 (Ch).
19 *Re Van Gansewinkel Groep BV* [2015] EWHC 2151 (Ch).
20 *In Re La Seda de Barcelona SA* [2010] EWHC 1364 (Ch).
21 Ibid., at 19.
22 *In the Matter of Noble Group Limited* [2018] EWHC 3092 (Ch).

agement, a group of its senior creditors, their related parties and officers, directors, employees, agents, advisors, and representatives. It encompassed claims relating to the scheme claims and the preparation, negotiation, sanctioning or implementation of the scheme. The court acknowledged the breadth of the suggested release to include any claims arising from or related to the scheme claims. This, however, was not found to be problematic. When sanctioning the scheme with a third-party release, it mentioned that an issue could arise where a scheme creditor has a more "tangential" claim against the to-be-released third party (e.g. a claim by a creditor in negligence against an independent financial adviser who advised that creditor to purchase financial instruments). The court noted that this could affect class composition, because only some, but not all, scheme creditors would be entitled to pursue such a claim.

In sum, English schemes of arrangement are flexible and commercially driven when it comes to third-party releases. It is well established that in certain circumstances, a scheme can, as part of the arrangement between the scheme company (the "anchor" debtor) and a creditor, require the creditor to give up or vary its rights against a third party, a person other than the scheme company. Claims arising from various types of intercompany liability arrangements (guarantees, co-debtorship, third-party collateral), facilitating group interconnectedness and interdependence, will commonly be eligible for a release. This is because such a release may be seen as necessary to give effect to the proposed arrangement. Without it, the guaranteed creditor is entitled to sue the guarantor, and the guarantor is then entitled to claim the entire amount from the principal debtor (i.e. a scheme company) in accordance with the guarantor's right to an indemnity (section 6.5.3.1.). This indemnity claim can defeat the purpose of the whole scheme, as the principal debtor would ultimately remain liable for the very amount that was purportedly compromised by the scheme.

The mechanism frequently adopted to achieve a release of group guarantors is through a clause in the scheme that confers authority upon a nominated person to execute a deed of release or variation on behalf of the scheme creditors in favour of third parties.[23] The release can be granted where the "anchor debtor" is a principal debtor,[24] where it is one of the principal

23 *Re Noble Group Ltd (sanction)* [2019] 2 BCLC 548, at 24; *Re Van Gansewinkel Groep BV* [2015] Bus LR 1046, at 16.

24 *Re APCOA Parking Holdings GmbH* [2014] EWHC 3849 (Ch), 2014 WL 5833966; *In the Matter of Noble Group Limited* [2018] EWHC 3092 (Ch).

debtors,[25] or where it is a guarantor.[26] Three aspects are worth emphasising concerning third-party releases under English law.

First, a wide range of "third parties" may benefit from a release. These parties can include both related parties (e.g. group entities, their directors and officers) and non-affiliated parties (e.g. insurers, auditors, legal and financial advisors).[27] Second, claims subject to a release can be contractual (e.g. based on a guarantee, co-debtorship or collateral arrangement) or non-contractual (e.g. arising in tort), secured or unsecured. Third, there are certain requirements imposed on third-party releases. Payne distinguishes four of them:[28]

- A scheme should involve a genuine "give and take". This does not necessarily entail equal monetary consideration and could include indirect benefits in the short or long run (e.g. financial stability of the group as a whole). English courts do not always closely scrutinise this requirement.[29]
- Creditors' rights against a third party must be sufficiently closely connected with the claims against the principal debtor. This includes claims under guarantees, co-debtorship and collateral arrangements, but may also encompass other claims that potentially affect the success of the proposed scheme and obligations of the principal debtor. The review

25 *Re NN2 Newco Ltd* [2019] EWHC 1917 (Ch). In this case, NN2 was specifically incorporated in England for the purposes of facilitating a scheme of arrangement. Upon incorporation, NN2 voluntarily became co-issuer and co-obligor under financial obligations, assuming joint and several liability under the debt instruments. The court noted that such a technique to create jurisdiction for a scheme was not abusive. Also, *Re Codere (UK) Ltd* [2015] EWHC 3778 (Ch).

26 *In the Matter of Swissport Fuelling Ltd* [2020] EWHC 1499 (Ch). In this case, a scheme company was a guarantor rather than a borrower. It was incorporated in England and Wales. The borrowers were incorporated in Luxembourg and Switzerland and might not have been able to establish a sufficient connection with the UK. Under the credit agreement, the borrowers did not have a right of contribution or indemnity against the guarantors, so a claim against them would not ricochet against the scheme guarantor. In order to change this and create such a ricochet claim, the scheme company entered into a deed in favour of the borrowers. Under this deed, it assumed the position of a primary obligor, alongside the borrowers, so that each of them would have a right of contribution against the other.

27 C. Pilkington, Schemes of Arrangement in Corporate Restructuring, Sweet & Maxwell, 2017, para. 9-001, noting that there are four main categories of third parties for whose benefit a release is often granted, namely: (i) third party security providers (e.g. operating company guarantors); (ii) advisers; (iii) directors; and (iv) administrators or liquidators.

28 J. Payne, Schemes of Arrangement: Theory, Structure and Operation, CUP, 2014, pp. 23-24.

29 *In the matter of Syncreon Group BV* [2019] EWHC 2412 (Ch), 2019 WL 04279919, at 26, briefly noting that the scheme companies confirmed the need of third-party releases "in order to give full effect to the schemes" and that such releases are "a relatively regular feature of the schemes." The court mentioned that the release provisions were explained to creditors.

of recent cases shows that the requirement of "close connection" is not closely examined by courts.[30] In any case, claims under cross-guarantees are seen as closely connected to the creditor's claim against the principal debtor, as both claims aim to recover the same loss.

- Creditors' rights against a third party must be personal and not proprietary (i.e. not based on creditors' title over assets).
- A creditor should benefit from a release of his rights against the third party "to the extent that if it were to exercise them this would adversely affect what it might recover under the scheme."[31]

The question remains whether the scheme of arrangement can be approved if, as a result of a third-party release, the guaranteed creditor is disadvantaged. It is essential to note that the majority of English schemes of arrangement are uncontested. Therefore, the issue of third-party releases and their fairness is rarely explicitly addressed by English courts. However, the compliance of third-party releases with the constitutional protection of private property was discussed by the High Court of Ireland in *Re Ballantyne Re PLC*. In this case, the court observed that "the requirement to obtain the sanction of the Court for a scheme of arrangement […], which sanction will not be granted if this scheme is unfair, inequitable, improperly coercive or unreasonable […], combined with the requirement for a special majority at the relevant scheme meeting as a pre condition for such sanction […], represents a fair, reasonable and proportionate balance […] of the various potentially competing interests involved in a scheme of arrangement."[32]

English courts are likely to follow the same approach. They are generally unwilling to replace the will of the majority of creditors with their own views on the commercial merits or on what is reasonable.[33] When deciding whether to sanction a scheme, courts consider whether there are reasons to doubt that the majority of creditors have made a decision that a reasonable creditor would have arrived at when assessing the proposal. Yet it is important to keep in mind that the court's sanctioning of a scheme is not a rubber-stamping exercise, even if the scheme is supported by the majority

30 See *In the Matter of Noble Group Limited* [2018] EWHC 3092 (Ch), at 25, noting that "[t]he jurisdiction is not […] limited to guarantees and claims closely connected to scheme claims."

31 J. Payne, Schemes of Arrangement: Theory, Structure and Operation, CUP, 2014, p. 31.

32 *Re Ballantyne RE Plc & Companies Act 2014* [2019] IEHC 407, at 130.

33 *Re Equitable Life Assurance Society* [2002] EWHC 140 (Ch). See G. McCormack, The European Restructuring Directive, Edward Elgar Publishing, 2021, paras. 6.47-6.50, describing the "creditor democracy" approach adopted with respect to schemes of arrangement.

of voting creditors.[34] In considering the general fairness of a scheme, the court may scrutinise a third-party release and its effect on a guaranteed creditor. If the release is fully disclosed and is not manifestly unfair, it is likely to be sanctioned by the court.[35] This might be the case where evidence demonstrates that an insolvent liquidation is a likely scenario if the scheme is not approved, and that the scheme provides each scheme creditor with a better return than they would receive in an insolvency proceeding.[36]

By contrast, if a scheme of arrangement with a third-party release is forced on a guaranteed creditor, deprives him of the benefits of the guarantee, and worsens his position compared to an alternative scenario, there can be valid concerns about the inherent unfairness of the release and of the scheme itself. This was confirmed in the context of CVAs. For example, in *Mourant & Co Trustees Ltd v. Sixty UK Ltd*, the court found that an alternative to the CVA, the liquidation, would not deprive the landlords of the guarantees for the remainder of the leases, which the CVA would do.[37] The guarantees were of obvious commercial value, and the very reason they were given in the first place was to protect landlords in case of tenant default. The release was therefore not sanctioned. Thus, the issue of fairness may arise when a particular creditor has a more tangential claim against a third party, and this claim is being compromised through a release. Such a claim can be based on a guarantee.[38]

The existence of a separate claim could also be relevant for class composition.[39] The recent case of *Gategroup* highlights this issue. Gategroup, a

---

34 *Re Stemcor Trade Finance Limited* [2015] EWHC 2803 (Ch); *Re Sunbird Business Services Limited* [2020] EWHC 2493 (Ch); *Re All Scheme Limited* [2021] EWHC 1401 (Ch) (given specific circumstances of the case (e.g. low level of creditor turnout, limited financial sophistication and literacy of creditors, unsatisfactory presentation of realistically probable alternatives to the scheme), the court questioned fairness of the scheme whereby the creditors were to suffer a 90% haircut, while the shareholders retained their economic interest in the group).

35 C. Pilkington, Schemes of Arrangement in Corporate Restructuring, Sweet & Maxwell, 2017, para. 9-021.

36 *Re Lecta Paper UK Ltd* [2020] EWHC 382 (Ch), at 29. The relevance of the comparator to the scheme, or the counterfactual of what would be an alternative if the proposed scheme does not proceed was considered in *Re Stronghold Insurance Co Ltd* [2019] BCLC 11, at 49, stating that "[…] only by identifying the comparator can the likely practical effect of what is proposed be assessed and the likelihood of sensible discussion between the holders of rights so affected and between them and others with different rights be weighed fairly."

37 *Mourant & Co Trustees Ltd v. Sixty UK Ltd* [2010] B.C.C. 882.

38 See *Re Virgin Active Holdings Limited* [2021] EWHC 1246 (Ch), at 206.

39 *Re Noble Group Ltd* [2018] EWHC 3092 (Ch), at 26, suggesting that "issues of class composition could arise on the facts if, for example, some but not all scheme creditors had such a claim against a third-party adviser." The leading case on class composition is *Sovereign Life Assurance v. Dodd* [1892] 2 QB 573, per Bowen LJ at 583, holding that a class must be confined to those persons whose rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interest. Other relevant cases include *Re Hawk Insurance Co Ltd* [2001] EWCA Civ 241 and *Re UDL Holdings Ltd* [2002] 1 HKC 172.

leading global provider of airline catering services, experienced a massive decline in business due to the Covid-19 pandemic. To avoid insolvency, a Part 26A restructuring plan was proposed.[40] The plan involved two groups of creditors: Bondholders and Senior lenders. The rights of these creditors were guaranteed by the specifically incorporated Plan Company via the Deed Poll, under which the Plan Company undertook to indemnify the creditors in respect of the obligations of primary obligors. It is important to note that the primary obligors under bonds and loans were *different group entities*. The main question was whether there should be one or two classes of creditors. The court refused to put Bondholders and Senior Lenders in a single class, as their rights were considered to be "materially different, being against different entities [different obligors]."[41] The court also considered that the rights conferred by the plan on the respective creditors were different. For example, maturity dates were not the same, reflecting the existing contractual rights. The relevance of the rights against third parties (e.g. group guarantors) for class composition has been confirmed more recently.[42]

10.2.3 The USA: third-party releases in Chapter 11

Explaining the attractiveness of Chapter 11 among foreign companies, McCormack mentions several factors: (i) the worldwide automatic stay; (ii) the DIP regime; (iii) developed rules on rescue financing; (iv) cram down possibilities; and (v) procedural consolidation.[43] The availability of third-party releases is not cited. This section explains why this is the case. The position of US bankruptcy law on third-party releases is complex and unsettled. To clarify the current US approach, three points should be made.

First, US courts distinguish between a temporary injunction staying the enforcement and suits against third parties, and a permanent release of claims against them. It is generally accepted that injunctions to protect third parties, such as guarantors and co-debtors, are permissible in certain circumstances (see further section 11.3.2.).

---

40 In *Re Virgin Atlantic Airways Ltd* [2020] EWHC 2191 (Ch), at 45-48, it was concluded that the same approach to class constitution applies to a Part 26A plan as to a Part 26 scheme of arrangement.

41 *Re Gategroup Guarantee Limited* [2021] EWHC 304 (Ch), at 189.

42 *Virgin Active Holdings Ltd & Ors, Re Part 26A of The Companies Act 2006* [2021] EWHC 814 (Ch), at 81.

43 G. McCormack, Bankruptcy Forum Shopping: The UK and US as Venues of Choice for Foreign Companies, International and Comparative Law Quarterly, Vol. 63, 2014, p. 827.

Second, US courts usually approve third-party releases when there is affirmative and explicit consent by creditors whose claims are being released.[44] Differing opinions, however, exist about what constitutes "consent", and whether deemed or implied consent suffices to sanction a third-party release.[45] Some courts find voting in favour of a reorganisation plan sufficient to assume consent to a third-party release included therein,[46] whereas other courts require manifest assent to the release, so that mere voting for a plan is not enough.[47] The third category of courts considers abstaining from voting or failure to opt out as consent.[48] The Commission established by the American Bankruptcy Institute to study the reform of Chapter 11 in its report favours express consent to the release, which covers: (i) voting for a plan that includes a third-party release; (ii) a separate point on the ballot indicating consent to a release; or (iii) a separate agreement with the affected creditor approving the release.[49]

Third, non-consensual third-party releases are particularly problematic in US bankruptcy law. It is difficult to summarise the position of US courts on the issue, as there is no harmonised and consistent approach, but rather a great variety of varying and, at times, conflicting approaches. This issue has split the federal circuits for decades. US statutory law does not expressly and unequivocally permit third-party releases, except in asbestos-related liability.[50] In fact, § 524(e) states that a "discharge of a debt of the debtor *does not affect the liability of any other entity* on, or property of any other entity for,

44 *In re SunEdison, Inc.*, 576 B.R. 453, 458 (Bankr. S.D.N.Y. 2017); *In re Specialty Equip. Cos., Inc.*, 3 F.3d 1043, 1047 (7th Cir. 1993).

45 See D. Coco, Third-Party Bankruptcy Releases: An Analysis of Consent Through the Lenses of Due Process and Contract Law, Fordham Law Review, Vol. 88, 2019, p. 233, arguing that the existing divergence in case law leads to inconsistent application of the US Bankruptcy Code, raises due process concerns, and causes forum shopping.

46 *In re Chassix Holdings Inc.*, 533 B.R. 64 (Bankr. S.D.N.Y. 2015); *In re Zenith Elecs. Corp.*, 241 B.R. 92, 111 (Bankr. D. Del. 1999).

47 *In re Digital Impact, Inc.*, 223 B.R. 1, 14-15 (Bankr. N.D. Okla. 1998), emphasising that the court "must ascertain whether the creditor unambiguously manifested assent to the release of the nondebtor from liability on its debt."

48 *In re DBSD N. Am., Inc.*, 419 B.R. 179, 217-19 (Bankr. S.D.N.Y. 2009), holding that "[e]xcept for those who voted against the Plan, or who abstained and then opted out, […] Third Party Release provision [is] consensual." *In re Indianapolis Downs, LLC*, 486 B.R. 286, 306 (Bankr. D. Del. 2013), stressing that "parties were provided detailed instructions on how to opt out, and had the opportunity to do so by marking their ballots."

49 ABI Commission to Study the Reform of Chapter 11, Final Report and Recommendations, 2014, p. 255.

50 11 U.S. Code §524(g)(1)(B). Even in asbestos-related cases, it is not entirely clear whether liability, other than the derivative liability of the debtor, can be released. J.M. Silverstein, Overlooking Tort Claimants' Best Interests: Non-Debtor Releases in Asbestos Bankruptcies, UMKC Law Review, Vol. 78, 2009, p. 63, arguing that the language of this section "suggests that supplemental injunctions may not extinguish rights against a third party arising from the *third party's independent conduct*" (original emphasis).

such debt"[51] (emphasis added). Courts grapple with the scope and application of this provision. A few circuits (Ninth,[52] Tenth,[53] and Fifth[54] circuits) have adopted a restrictive view on third-party releases, ruling that § 524(e) prohibits them.[55] Other circuits avoid this narrow interpretation and, under certain limited conditions, are willing to consider and approve third-party releases. They focus on § 105(a), which grants US courts the equitable power to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the US Bankruptcy Code]."[56] Yet even for them, the permissibility of third-party releases does not result in a single judicial standard.

For instance, in *Dow Corning Corporation*, the Sixth Circuit listed seven factors necessary for the approval of a third-party release. According to these, a release can be granted if:

> (1) There is an identity of interests between the debtor and the third party, usually an indemnity relationship, such that a suit against the non-debtor is, in essence, a suit against the debtor or will deplete the assets of the estate; (2) The non-debtor has contributed substantial assets to the reorganization; (3) The injunction is essential to reorganization, namely, the reorganization hinges on the debtor being free from indirect suits against parties who would have indemnity or contribution claims against the debtor; (4) The impacted class, or classes, has overwhelmingly voted to accept the plan; (5) The plan provides a mechanism to pay for all, or substantially all, of the class or classes affected by the injunction; (6) The plan provides an opportunity for those claimants who choose not to settle to recover in full and; (7) The bankruptcy court made a record of specific

51 11 U.S. Code §524(e).

52 *Resorts Int'l, Inc. v. Lowenschuss (In re Lowenschuss)*, 67 F.3d 1394, 1402 (9th Cir. 1995), restating that "[t]his court has repeatedly held, without exception, that §524(e) precludes bankruptcy courts from discharging the liabilities of nondebtors."

53 *Landsing Diversified Props.-II v. First Nat'l Bank & Trust Co. of Tulsa (In re W. Real Estate Fund, Inc.)*, 922 F.2d 592, 601 (10th Cir. 1990), holding that "Congress did not intend such [discharge of debt] to third-party bystanders."

54 *Bank of N.Y. Tr. Co. v. Official Unsecured Creditors' Comm. (In re Pac. Lumber Co.)*, 584 F.3d 229, 252 (5th Cir. 2009).

55 For criticism of the position that § 524(e) bars third-party releases, see R. Brubaker, Bankruptcy Injunctions and Complex Litigation: A Critical Reappraisal of Non-Debtor Releases in Chapter 11 Reorganizations, University of Illinois Law Review, Vol. 1997, 1997, p. 971, arguing that while "a bankruptcy court does, indeed, lack the authority to approve a nonconsensual release of creditors' non-debtor claims, courts' and commentators' reliance upon section 524(e) as a statutory prohibition is misguided and unfortunate. Section 524(e) is necessary, as a matter of mere mechanics, to prevent the debtor's discharge from automatically discharging co-debtors and guarantors, through the operation of common-law suretyship rules that release secondary obligors upon release of the primary obligor."

56 11 U.S. Code §105(a).

factual findings that support its conclusions.[57]

A comprehensive analysis of the different tests applied by circuits in adjudicating the issue of third-party releases falls outside the scope of this book. Some circuits prohibit them, noting that they contravene the statutory language of § 524(e) of the US Bankruptcy Code. Others apply the heightened scrutiny standard,[58] highlighting that third-party releases can be allowed in rare, unique and unusual cases,[59] where the release is "integral" to and "absolutely required" for the reorganisation.[60]

The hesitation of US courts in approving non-consensual releases can also be explained by the risks of their abuse. As the court in *Metromedia* warned, "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."[61] The availability of third-party releases has recently entered the spotlight in view of the Purdue Pharma's Chapter 11 plan of reorganisation. This plan included a settlement with the Sackler family, whereby, in exchange for the release of third-party claims against over 1,000 individuals and entities related to the Sackler family ("shareholder released parties"), the Sacklers initially agreed to provide USD 4.275 billion towards the insolvency estate; that number reached appr. USD 6 billion on appeal. The release was to extend to all present and potential claims connected to the opioid crisis. The plan was approved by well above the 75% supermajority in each class of creditors and was confirmed by the Bankruptcy Court for the Southern District of New York (Judge Drain) in September 2021.[62] The court ruled that the settlement was necessary for the plan and that the plan was reasonable and fair. On appeal, the Bankruptcy Court's confirmation order was vacated. The

57 *Class Five Nev. Claimants v. Dow Corning Corp. (In re Dow Corning Corp.)*, 280 F.3d 648, 658 (6th Cir. 2002). The same factors are applied by the Fourth Circuit, see *Nat'l Heritage Found., Inc. v. Highbourne Found.*, 760 F.3d 344, 348-51 (4th Cir. 2014). In its recommendations (p. 256), the ABI Commission rejected the application of the Dow Corning factors and favoured a different test applied in *Re Master Mortg. Inv. Fund Inc.*, 168 B.R. 930 (Bankr. W.D. Mo. 1994).

58 The trend towards an increasingly restrictive interpretation has also been noted in the literature. See M.S. Etkin, N.M. Brown, Third-Party Release? – Not So Fast! Changing Trends and Heightened Scrutiny, AIRA Journal, Vol. 29, 2015, p. 26, concluding that "a focus on the courts' application of the standards illustrates the movement of the Permissive Circuits towards a more restrictive view."

59 *Deutsche Bank AG, London Branch v. Metromedia Fiber Network, Inc. (In re Metromedia Fiber Network, Inc.)*, 416 F.3d 136, 141 (2d Cir. 2005); *In re Dow Corning Corp*. 280 F.3d 648, 657–58 (6th Cir. 2002), stressing that a third-party release is "a dramatic measure to be used cautiously." *In re Transit Grp., Inc.*, 286 B.R. 811, 817 (Bankr. M.D. Fla. 2002), explaining that courts that grant third-party releases "hold that the granting of such releases is justified only in unusual circumstances."

60 *In re Millennium Lab Holdings II, LLC.*, 945 F.3d 126, 137 (C.A.3 (Del.), 2019).

61 *In re Metromedia Fiber Network, Inc.*, 416 F.3d 136, 142 (2nd Cir. 2005).

62 *In re Purdue Pharma L.P.*, 633 B.R. 53 (Bankr. S.D.N.Y. 2021).

US District Court for the Southern District of New York (Judge McMahon) concluded, in a rather broad statement, that the US Bankruptcy Code did not authorise non-consensual non-debtor releases.[63] Finally, the cases ended up in the Court of Appeals for the Second Circuit, which overturned the US District Court's ruling and held that the Bankruptcy Court's initial approval of the releases was appropriate.[64]

In light of the heated debates about the lawfulness and desirability of bankruptcy third-party releases, and given the split between circuits regarding this practice, a bill titled the "Nondebtor Release Prohibition Act of 2021" was proposed in July 2021.[65] This bill aims to prohibit non-consensual, non-debtor releases in bankruptcy proceedings. On this point, it should be noted that the bill was triggered by cases like Purdue Pharma, involving mass torts, rather than by reorganisations of corporate groups and the restructuring of liability from intra-group financing – the main subject of this book.[66] It appears that the negative attitude and high scrutiny apply primarily to mass tort releases, and not necessarily to the restructuring of group guarantees.

10.2.4 The Netherlands: third-party releases in WHOA schemes

10.2.4.1 General release framework

Prior to the adoption of the WHOA, Dutch law did not have statutory rules dealing with third-party releases. Outside the WHOA framework, examined below, the possibility of releasing third parties in plans adopted in bankruptcy and suspension of payments procedures remains unclear. In academic literature, the predominant view seems to be that such releases are only available if the creditor consents to a release.[67]

---

63 *In re Purdue Pharma, L.P.*, 635 B.R. 26 (S.D.N.Y., 2021).

64 *In re Purdue Pharma L.P.*, No. 22-110, 2023 WL 3700458 (2d Cir. May 30, 2023).

65 H.R.4777 - Nondebtor Release Prohibition Act of 2021.

66 For the analysis of third-party releases in bankruptcy proceedings involving mass-tort liability, see L.D. Simon, Bankruptcy Grifters, The Yale Law Journal, Vol. 131, 2022, pp. 1154-1216; R. Brubaker, Mandatory Aggregation of Mass Tort Litigation in Bankruptcy, The Yale Law Journal Forum, Vol. 131, 2022, pp. 960-1009; E.J. Janger, Aggregation and Abuse: Mass Torts in Bankruptcy, Fordham Law Review, Vol. 91, 2022, pp. 362-383; A.J. Casey, J.C. Macey, In Defense of Chapter 11 for Mass Torts, The University of Chicago Law Review, Vol. 90:3, 2023, pp. 973-1021.

67 S.C.J.J. Kortmann, Derden in het faillissementsrecht (1997) 46 AA 5, p. 59-60; A.D.W. Soedira, Het Akkoord. Een wetenschappelijke proeve op het gebied van de rechtsgeleerdheid (Onderneming en recht, nr. 60) (diss. Nijmegen), Deventer: Kluwer, 2011, p. 93-96; A.M. Mennens, Het dwangakkoord buiten surseance en faillissement (Onderneming en recht nr. 118), Deventer: Wolters Kluwer, 2020, p. 495ff; B. Wessels, Het Akkoord (Wessels Insolventierecht nr. VI), 5e druk, Wolters Kluwer, 2020, 6159ff; K. Harmsen, Lehman Brothers: een akkoord in strijd met de Faillissementswet, TvI 2013/28.

This position is substantiated with reference to the nature of a plan, which is seen as an agreement between the debtor and its creditors, and which therefore requires creditor consent (*aanvaarding*). In other words, the binding effect of a release arises from such consent rather than from a court approval of a plan. The release provisions are believed to be extraneous to a plan (*akkoordvreemde bepalingen*), as they do not concern the debtor-creditor relationship but regulate creditor-third party relationship. However, Vriesendorp and Hermans,[68] and Tollenaar[69] argue that a plan should be able to affect creditors' rights against third parties, even over creditors' disagreement. Be it as it may, in practice, third party releases have been included in bankruptcy and suspension of payments plans.[70] They purported to release, among others, debtor's directors, bankruptcy trustees, direct and indirect shareholders, group members, their insurers and advisors from potential liability vis-à-vis creditors who were part of the plan. Yet these third-party releases were either not challenged or not invoked after the approval of a plan. Hence, the limits of what could be agreed in a plan have not been tested in courts. The same is true for WHOA plans that contain releases of directors, board members, agents and other parties, whose releases are not based on any specific statutory rule.[71] This is different for releases of group members discussed below.

As previously noted, the starting point is that a WHOA scheme, just like any other procedure under the Dutch Bankruptcy Act, does not affect creditors' rights vis-à-vis third parties, i.e. guarantors and co-debtors, who are liable for the debt of the debtor proposing the plan.[72] In the context of group financing, where several group members give security or act as co-borrowers, this means that the restructuring of obligations of one group member does not affect creditor's rights against other group members. Such group members remain liable to pay the debts which have been restructured. This could lead to their insolvency and, given group operational and financial interdependence, it can undermine the chances for the survival of the restructured debtor. If so, the goal of rescuing the viable business will not be achieved. With this in mind and to facilitate restructuring within enterprise groups, the Dutch Bankruptcy Act in its articles on WHOA schemes,

68 R. Hermans, R.D. Vriesendorp, Het dwangakkoord in het insolventierecht: vrijheid in gebondenheid? TvI 2014/10.

69 N.W.A. Tollenaar, Het pre-insolventieakkoord. Grondslagen en raamwerk (diss. Groningen), Deventer: Wolters Kluwer, 2016, p. 300-302.

70 Rb. Amsterdam 22 March 2013, *JOR* 2013/191, m.nt. W.J.M. van Andel (*Lehman Brothers Treasury Co. B.V.*); Rb. Amsterdam 23 September 2021, *JOR* 2022/17, m.nt. R.J. van Galen (*Steinhoff International Holdings N.V.*).

71 Rb. Amsterdam 21 June 2023, ECLI:NL:RBAMS:2023:4152 (*Steinhoff International Holdings N.V.*), 12.10., noting that the "court sees no grounds for rejecting the homologation request in the foregoing, noting that the court will not rule on whether the Release Clause can be invoked by or against third parties after homologation."

72 Dutch Bankruptcy Act, Article 370(2) and Article 160.

provides an exception to the general rule of "no-third-party-effect". It offers a debtor or a restructuring expert the option to propose the restructuring of group obligations under a single plan.[73] Without this option, each member of a group would need to initiate its own proceedings to restructure obligations under the guarantees.

The WHOA introduced Article 372 Fw, which establishes that a WHOA plan can amend the rights of creditors against third parties (non-debtors), which must be debtor's group members. This is possible if these group entities have not offered a plan to restructure relevant obligations themselves. The definition of a "group" under Dutch law was discussed in section 2.3. In the ensuing paragraphs, we will first address the scope of the rules on third-party releases, and then provide an overview of the conditions for a third-party release.

When it comes to the (personal) scope, a WHOA plan can amend the rights of creditors against group entities, provided that the rights against such entities entail payment of or provision of security for the obligations of the debtor or obligations for which these legal entities are liable together with or alongside the debtor. Going back to the example of a group mentioned earlier, if Company A is the principal debtor (borrower) and Company B provided a guarantee to secure Company A's obligation to the Bank, a WHOA plan adopted for Company A could amend the Bank's claim against Company B. This is a simple case. The application of the WHOA's rules in other cases may be less straightforward. Two such cases are identified below.

73 A restructuring expert (*herstructureringsdeskundige*) is an independent insolvency officer who can be appointed by the court to develop and propose a WHOA plan to the debtor's creditors and shareholders, or to some of them. See Article 371 Fw. The appointment of a restructuring expert does not mean that the debtor ceases to be a debtor in possession; the debtor does not lose any powers other than those related to the WHOA plan.

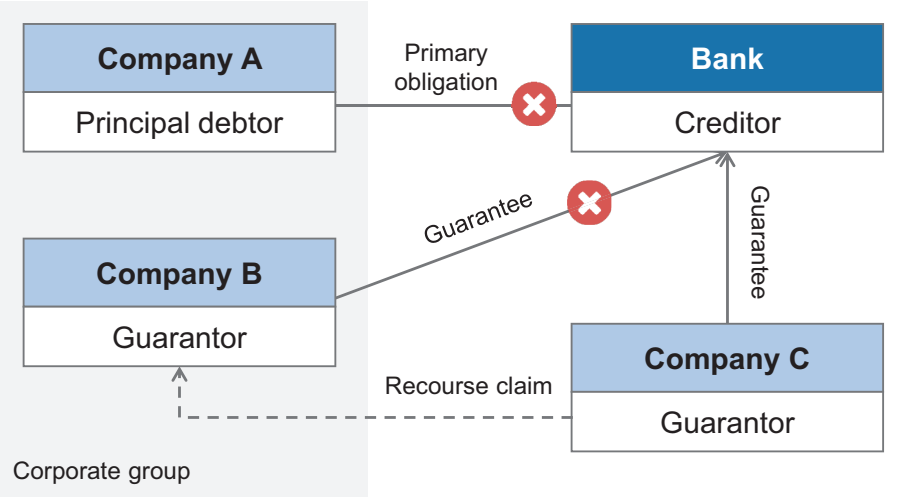

Figure 11. Third-party release with a non-group guarantor (Case 1)

The first case has the same facts, except that there is a non-group entity, Company C, which has also guaranteed Company A's obligations. Let us assume that upon payment to the Bank, Company C is entitled to collect from Company B in full. Company A initiates a WHOA procedure and proposes a plan that releases the obligations of Company B, so that the Bank cannot force it to pay. However, this WHOA plan does not release Company C from its obligations under the guarantee since Company C is not part of the enterprise group. This is why the Bank is not prevented from suing Company C for the full outstanding amount. In turn, Company C can sue Company B based on a *regres* claim. If such a claim threatens the group restructuring, a third-party release is of limited use. This example demonstrates the limitations of the Dutch approach to third-party releases. While it is clear that a WHOA scheme can release group entities on obligations owed by the debtor, it is less clear whether it can release a non-debtor group entity (Company B) from obligations owed to its own creditors. The most likely answer is that it cannot. Therefore, Company B needs to start its own WHOA procedure and restructure debts owed to Company C.

The second case involves the same groups of companies, but there is another group entity, Company D that has extended a guarantee to the Bank. Thus, there are two group members, Company B and Company D, acting as guarantors for Company A's obligation (first-level guarantees). In addition to guaranteeing the debt of the principal debtor, Company A, Company B and Company D have guaranteed the obligations of each other (second-level guarantees). In other words, the guarantors have cross-guaranteed each other's obligations to the Bank, and in this way, they have become the principal debtors to each other. As in the case above, the WHOA plan releases the initial, first-level guarantees. Does it also release second-level guarantees?

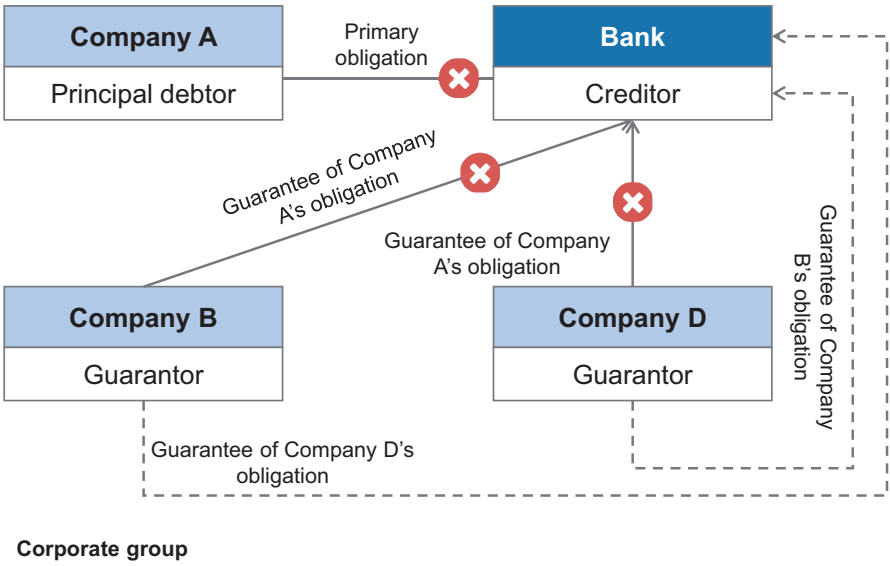

Figure 12. Third-party release and cross-guarantees between guarantors (Case 2)

As a general rule, a surety is liable for the original debt, even if such debt has been restructured in a WHOA plan. Therefore, one could argue that the second-level guaranteed debt survives the release of the first-level guarantees. However, the question remains whether a WHOA plan can also release second-level obligations. Providing a definitive answer to this question is difficult. Article 372 Fw states that a WHOA plan may amend the rights of creditors against group members, but only if the creditors' rights against such group members are intended to satisfy or secure the performance of obligations of the scheme debtor or obligations for which those legal persons are liable with or in addition to the scheme debtor. In our case, Company B and Company D have guaranteed each other's obligations. These obligations are separate and distinct from the obligations of the scheme company (Company A). Consequently, we are dealing with two separate *principal* obligations. Since neither of the guarantors – each being the principal debtor to each other – is subject to a WHOA scheme, their own separate obligations may not be released by Company A's plan. If Company A has also provided a guarantee securing the obligations of its guarantors (which is unlikely), then such a release is possible, as the WHOA debtor would be a holder of the principal obligation.

One potential way to solve this puzzle is to open separate WHOA procedures for Company B and Company D and release their obligations in such procedures.[74] Yet this approach creates costs and weakens the legal framework for third-party releases, which aims to resolve intra-group obligations in one go. Nevertheless, one may argue that the obligations of the guarantors (Company B and Company D) under second-level guarantees are derived from the primary obligation of the scheme debtor (Company A), and hence should be capable of being released in the latter's WHOA plan.

10.2.4.2 Conditions for a third-party release

The Dutch Bankruptcy Act lists several conditions for third-party releases.

- First, claims against third parties should be ancillary to the obligations of the anchor debtor – a scheme company.[75] This means that the right of a creditor against a third party should involve the payment of or security for the obligations of the anchor debtor, or the obligations for which the third party is liable together with the anchor debtor. The obligations of group members capable of being released in a WHOA plan are given a broad interpretation and may include, inter alia, liabilities arising from the relationship of suretyship, co-debtorship and a 403-statement. It is also possible to release group obligations in a situation where the anchor debtor is not the principal debtor but a (co-)guarantor.[76] In this respect, Dutch law aligns with English case law with its flexibility. Yet, unlike English law, Dutch law does not provide for the release of persons other than group members, such as directors, insurers, legal and financial advisers.
- Second, a third party benefitting from a release must itself be in a state of financial distress,[77] so that it can reasonably be assumed that it will not be able to continue paying its debts as they fall due.[78] The foreseen financial distress may be connected to the enforcement of a guarantee or another intra-group liability arrangement. In integrated groups, group financial distress normally entails impending insolvency not only of the principal debtor but also of group guarantors. The requirement of

74 N.B. Pannevis, Insolventierecht, Deventer: Wolters Kluwer, 2022, 29.4.4., observing that if "the co-debtors wish to restructure their own debts in addition to their liability for the debt of the plan provider, for which they are jointly and severally liable, they could offer their own plans at the same time. Then there will be several plans. These plans can be handled jointly and, for example, be offered in a single document […]." Rb. Amsterdam 5 August 2021, ECLI:NL:RBAMS:2021:6519, *JOR* 2022/102, m.nt. R. van den Sigtenhorst.

75 Dutch Bankruptcy Act, Article 372(1)(a).

76 R. van den Sigtenhorst, in: T&C Insolventierecht, commentaar op art. 372 Fw.

77 Dutch Bankruptcy Act, Article 372(1)(b).

78 Dutch Bankruptcy Act, Article 370(1). The Explanatory Memorandum defines this access criterion as "imminent insolvency" or "unavoidable insolvency". MvT, *Kamerstukken II* 2018/19, 35249, 3. This is a situation where the debtor has not yet ceased to pay its debts and is still able to meet its current obligations, but the debtor foresees that there is no realistic prospect of averting future insolvency if its debts are not restructured.

financial distress is added to prevent situations in which creditors are barred from pursuing their claims against solvent group members.

- Third, the group entities concerned need to consent to the release, or the plan should be proposed by a restructuring expert pursuant to Article 371 Fw.[79]
- Fourth, the court should have jurisdiction over third parties in a situation where these legal entities would themselves offer a restructuring plan.[80] In a public procedure, this amounts to either the presence of COMI or establishment (as defined under the EIR Recast) of all relevant group entities in the Netherlands,[81] or of the presence of their COMI or establishment in a non-EU jurisdiction (or in Denmark, as it falls outside the EIR Recast regime).[82] In a non-public WHOA procedure, sufficient connection to the Netherlands suffices.[83]

Additionally, the law stipulates that when deciding on the request to confirm a WHOA plan that restructures claims against guarantors, a court, on its own initiative (*ex officio*) or upon request, assesses whether the proposed plan "in respect of these third parties" (*ten aanzien van deze rechtspersonen*) complies with the general confirmation criteria contained in Article 384 Fw.[84] In other words, the statutory confirmation criteria should be satisfied with respect to each third party, whose obligations are restructured via the plan. This is a rather peculiar norm that does not have analogues in US or UK law.

Following this norm, for example, similar to the scheme company, the guarantor must be in a state of impending financial distress. The plan or supplementing documents, as prescribed by Article 375 Fw, should encompass all relevant information covering the group entities benefiting from a

79 Dutch Bankruptcy Act, Article 372(1)(c).

80 Dutch Bankruptcy Act, Article 372(1)(d).

81 The public WHOA scheme (*De openbare akkoordprocedure buiten faillissement*) is covered by the jurisdictional rules of the EIR Recast. See Regulation (EU) 2021/2260 of 15 December 2021 amending Regulation (EU) 2015/848 on insolvency proceedings to replace its Annexes A and B. A non-public WHOA scheme does not fall within the scope of the EIR Recast.

82 Dutch Bankruptcy Act, Article 369(7). Where COMI of a group entity is not in the EU (or is in Denmark), rendering the EIR Recast inapplicable, the jurisdiction of Dutch courts with respect to a public WHOA proceeding is determined on the basis of Article 3 of the Dutch Code of Civil Procedure. For the discussion of jurisdictional aspects of WHOA schemes and third-party releases, see R. Warner and M. Veder, Enterprise Group Restructuring: Dutch Options and United States Enforcement, European Insolvency and Restructuring Journal, 2021-7, 2021.

83 Dutch Code of Civil Procedure, Article 3, establishes a flexible jurisdictional basis, under which Dutch courts have jurisdiction when either the applicant or, where there are multiple applicants, one of them has its domicile or habitual residence in the Netherlands, or when the case is otherwise sufficiently connected to the Dutch legal system. Such connection may result from jointly-owed or guaranteed debt with a Dutch group member. See MvT, *Kamerstukken II* 2018/19, 35249, nr. 3.

84 Dutch Bankruptcy Act, Article 372(2)(b).

third-party release, as if such entities were to offer separate WHOA plans. This comprehensive information should include details about their financial position, as well as a properly documented statement of income and expenditures.[85] Since the group plan, referred to in the Dutch parliamentary documents as a "broad agreement" or "*breed akkoord*"[86], must meet the conditions related to disclosure and content with respect to each third party, some authors suggest that such a plan effectively incorporates "mini-plans" offered by relevant group companies.[87] We will revisit this view and explore potential problems it may create later in this chapter.

For the approval of a WHOA plan, a crucial issue is the formation of classes of creditors. Once it is determined which creditors are affected by the plan, the next question is whether these creditors will vote in one class or whether the plan provides for a class division. This division must meet the requirements of Article 374 Fw, which states that the division of creditors into classes should consider the rights that creditors have in the event of the realisation of the debtor's assets in bankruptcy or the rights given to them under the plan. Creditors should be allocated to separate classes if their rights are so different that they cannot be said to be in a comparable position. One court explained that "a correct class division gives meaning to the vote and a democratic justification for attributing legal effect to the majority opinion."[88]

In any event, creditors who have a different rank in insolvency must be divided into separate classes.[89] The question is whether creditors with claims against group guarantors should be placed in separate class(es). The answer will depend on whether the rights of such creditors against the guarantors are affected by the plan. In a recent case, the creditor argued that its position was significantly different from that of other unsecured creditors because it could enforce a guarantee if the principal debtor went bankrupt. Hence, the creditor contended that it should be placed in a separate class. The court rejected this argument and stated that the existence of a claim against the guarantor did not influence the position of the creditor

85 Dutch Bankruptcy Act, Article 375(2)(a) and 375(3)(d). See N.W.A. Tollenaar, Het pre-insolventieakkoord. Grondslagen en raamwerk (diss. Groningen), Deventer: Wolters Kluwer 2016, 8.11, explaining that information about the financial position of a third party needs to be provided to enable the affected creditors to make an informed decision about the proposed amendment or waiver of claims against the third party.

86 *Kamerstukken II* 2018/19, 35249, nr. 3, p. 44.

87 R. van den Sigtenhorst, in: T&C Insolventierecht, commentaar op art. 372 Fw. Also, R. van den Sigtenhorst, Herstructurering van groepen onder de WHOA, in: C.M. Harmsen & M.L.H. Reumers (red.), De WHOA van wet naar recht (Recht & Praktijk, nr. InsR18), Deventer: Wolters Kluwer 2021, 8.3.4; A.M. Mennens, Het dwangakkoord buiten surseance en faillissement (Onderneming en recht nr. 118), Deventer: Wolters Kluwer, 2020, 7.7.3.3.

88 Rb. Amsterdam 24 December 2021, ECLI:NL:RBAMS:2021:7643, r.o. 7.8.2.

89 Dutch Bankruptcy Act, Article 374(1).

under the plan or its recovery in the alternative (bankruptcy) scenario.[90] It is important to point out that the case at hand did not involve a third-party release.[91]

The outcome might be different if the creditor's rights against the guarantor are restructured in the plan. The reason for this is that the guaranteed creditor's position will be distinct from that of creditors who solely have a claim against the principal debtor, and this distinct position is specifically addressed (or altered) by the plan. As a result, guaranteed creditors subject to the effects of a third-party release should constitute a separate class or even classes of creditors.[92] The division of different guaranteed creditors into separate classes may be justified when their positions in the alternative scenario (e.g., insolvent liquidation) are not identical. This could occur, for example, if their rights under the guarantees are enforceable against different group companies, resulting in varying estimated rates of recovery. Consequently, the impact of the WHOA plan on the guaranteed creditors would differ, necessitating the division into separate classes. However, there are instances where different guaranteed creditors could potentially be grouped in the same class. One such example involves bondholders under two separate note programs, both secured by cross-guarantees offered by

90 Rb. Limburg 8 October 2021, *JOR* 2022/20, m.nt. Tekstra. The same was held in Rb. Amsterdam 24 December 2021, ECLI:NL:RBAMS:2021:7643, r.o. 7.8.1. Similarly, the Grand Court of the Cayman Islands in *In the Matter of Ocean Rig UDW Incorporated, Drill Rigs Holdings Incorporated, Drillships Financing Holdings Incorporated and Drillships Ocean Ventures Incorporated (each in provisional liquidation)* 2017 (2) CILR 495 held that for the purpose of class composition, the "fact that certain creditors had rights against other entities within the group was irrelevant as rights against third parties were not to be taken into account." It should be noted that in this case, the guarantor companies were subject to separate schemes and no third-party release was involved.

91 However, Rb. Midden-Nederland 10 November 2021, ECLI:NL:RBMNE:2021:5531, *JOR* 2022/21, mr. drs. N.B. Pannevis. In this case, the court seems to indicate that the fact that a creditor may sue several jointly and severally liable debtors, each proposing a plan, may impact the class formation, because for such a creditor the (overall) rate of recovery is higher compared to creditors who can only sue individual debtors.

92 N.W.A. Tollenaar, Het pre-insolventieakkoord. Grondslagen en raamwerk (diss. Groningen), Deventer: Wolters Kluwer 2016, 8.11; A.M. Mennens, Het dwangakkoord buiten surseance en faillissement (Onderneming en recht nr. 118), Deventer: Wolters Kluwer 2020, 7.7.3.3. R. van den Sigtenhorst, Herstructurering van groepen onder de WHOA, in C.M. Harmsen & M.L.H. Reumers (red.), De WHOA van wet naar recht (Recht & Praktijk, nr. InsR18), Deventer: Wolters Kluwer, 2021, 8.3.4, stating that it may be possible to put guaranteed creditors in the same class with non-guaranteed creditors, provided that (1) the position of the guaranteed creditors in bankruptcy, and (2) their rights under the plan do not differ to such an extent that there is no comparable position with creditors of the principal debtor with whom they are placed in one class. According to Van den Sigtenhorst, this is conceivable within groups, "certainly when there is a large or even complete financial interdependence." One can imagine a situation where group guarantees do not substantially affect the recovery rates of guaranteed creditors, for example, because the guarantors are hopelessly insolvent.

the same group members.[93] In this particular scenario, it might be easier to demonstrate that the actual (recovery) positions in the alternative scenario and under the plan do not substantially differ, making it unnecessary to classify them into separate classes.

Dutch law lays down the best-interest-of-creditors test as a key safeguard to protect the rights of creditors and shareholders. According to this test, "the court may refuse to confirm the plan […] if there is prima facie evidence that [the objecting] creditors or shareholders are worse off under the plan than they would have been in a liquidation of the debtor's assets in bankruptcy."[94] This provision ensures that a creditor cannot be forced to accept a smaller share in the value under the plan than it would receive in bankruptcy. If the creditor retains its claim against the guarantor, only the value of the principal debtor needs to be considered.[95] The situation changes when a WHOA plan includes a third-party release. A creditor whose rights under the guarantee are restructured and who did not support the plan may object to the plan's approval, citing a violation of the best-interest-of-creditors test.

If the creditor's claim against the guarantor is restructured, the court may be required to assess the payment the creditor would have received if it were to enforce such a claim. This exercise is inherently uncertain because it asks the court to explore a hypothetical scenario based on assumptions that are themselves uncertain. When dealing with intercompany guarantees, this exploration becomes even more complicated due to the need to examine the financial strength of the guarantor and determine the value of its assets and liabilities, including group liabilities and associated contribution issues. This problem is not new and has been previously mentioned in the context of transaction avoidance, where the difficulty of determining the value of a group guarantee and "predicting" an alternative (no-guarantee) scenario was emphasised (see Chapter 8). If the guarantor itself is insolvent or may become insolvent as a result of enforcement under the guarantee, the determination of prospective creditor pay-outs in its bankruptcy will have to be conducted.

---

93 See *Pathfinder Strategic Credit LP and another v. Empire Capital Resources Pte Ltd* [2019] SGCA 29, in which the issue of classification of guaranteed creditors was discussed. The question was whether the holders of different notes (2015 Noteholders and 2017 Noteholders), guaranteed by different group entities, should be classified as a single class for the purpose of voting on the scheme. The court observed that, assuming the alternative scenario is insolvent liquidation, the 2015 and 2017 Noteholders would be affected differently by the plan – the recovery rates in insolvency are different, but in the proposed scheme both creditors receive the same treatment. However, in the court's view, the difference in the recovery rates (i.e. 3%) was not significant enough to call for separate classes.

94 Dutch Bankruptcy Act, Article 384(3).

95 Rb. Limburg 8 October 2021, ECLI:NL:RBLIM:2021:8851, r.o. 3.3.21.

10.2.4.3 Potential impediments to third-party releases

The view of a group plan as encompassing mini-plans with respect to group guarantors might cause problems in practice. Two of the potential problems are discussed below.

First, let's imagine that a class of guaranteed creditors does not support the plan. Yet for the WHOA plan to be approved and crammed down on dissenting classes of creditors, if necessary, at least *one* in-the-money class of creditors must accept the plan.[96] Now, if we consider a third-party release as belonging to a separate mini-plan concerning the guarantor, and if we assume that the class of guaranteed creditors is the only class relevant for the approval of such a mini-plan (because the rights of other creditors and shareholders of the guarantor are not affected), the requirement of having "at-least-one-supporting-class" may not be complied with. As a result, the mini-plan and the third-party release contained therein will not take effect. This could present a roadblock to third-party releases.

Second, another example of a rule that may complicate the operation of a third-party release is the Dutch version of the absolute priority rule (APR). According to the Dutch Bankruptcy Act, the court shall refuse to confirm the plan if the distribution of value realised under the plan deviates to the disadvantage of the class that did not accept the plan from the ranking that applies upon the enforcement against the debtor's assets under Book 3, Title 10 BW ("Right of a creditor to take recourse against his debtor").[97] Again, if we adopt the "micro" view that a release falls under a separate mini-plan that needs to comply with key requirements, including compliance with the APR, if the affected class of guaranteed creditors does not support the plan, we may reach a conclusion that the plan violates the APR. This is because such a plan is likely to only affect guaranteed creditors and will probably not curtail the rights of lower-ranked creditors and shareholders of the group guarantor benefiting from the release.[98] After all, creditors and shareholders not involved in the plan will retain their entire claim against the group guarantor.

The first problem creates a strong holdout position for a class of guaranteed creditors, effectively blocking the possibility to cram down this class. One can also see this (essentially) veto right as an instrument of oppression by

96 Dutch Bankruptcy Act, Article 383(1).

97 Dutch Bankruptcy Act, Article 384(4)(b).

98 These potential obstacles to the adoption of a group plan were highlighted by A.M. Mennens, Het dwangakkoord buiten surseance en faillissement (Onderneming en recht nr. 118), Deventer: Wolters Kluwer, 2020, 7.7.3.3. Notably, the problem related to the APR rule does not arise in the UK, as this rule was not enacted in any form as a principle for the exercise of the discretion on sanctioning schemes of arrangement or Part 26A restructuring plans. *Re Virgin Active Holdings Limited* [2021] EWHC 1246 (Ch), at 289.

the minority. This is why, in this particular case, it is preferable to look at the group plan alone[99] instead of sub-dividing it into mini-plans. This interpretation is supported by the wording of Article 383(1) Fw, which states that at least one class of creditors must accept *the plan* (and not one class *per each mini-plan*). It can also be inferred from the wording of Article 372(2)(b) Fw, which only refers to compliance with the requirements of Article 384 Fw and does not mention Article 383(1) Fw. The absence of a reference to Article 383(1) Fw in the final text of the WHOA is especially notable in view of the fact that the WHOA's Explanatory Memorandum contained such reference to Article 383(1).[100]

The advocated "group approach" should facilitate estate value maximisation, making third-party releases a workable tool with benefits of reduced transaction costs and expedient debt restructuring. Moreover, as long as the best-interest-of-creditors test is in place, this "group approach" appears to be balanced and does not disproportionately encroach on the principles of equal treatment of creditors, protection of legitimate expectations, and party autonomy.

As for the second problem, it can also lead to a holdout position of a guaranteed creditor. This time, it may be more difficult to overcome because, in the absence of substantive consolidation, the APR applies at an entity level rather than at a group level.[101] This follows from the doctrine of entity separateness, which means that the guarantor has a pool of creditors (liabilities) and assets, separate from that of the principal debtor. As a result, creditors are ranked separately per legal entity, in accordance with the statutory order of priority ("waterfall"). One should keep in mind that the APR ensures a fair distribution of reorganisation value, which refers to the value of the company after the plan approval and implementation.[102] To determine whether the reorganisation value is fairly distributed, the size of a creditor's claim must be compared with the relative claim that this creditor has in the reorganisation value. No priority issue arises if the reorganisation value exceeds the debts, because each class receives 100%, and creditors affected

99 This approach was taken by the US court *in JPMorgan Chase Bank v. Charter Commc'ns Operating, LLC (In re Charter Commc'ns)*, 419 B.R. 221, 266 (Bankr. S.D.N.Y. 2009). In this case, the group plan involved a group entity with only one creditor and this creditor voted against the plan. Section 1129(a)(10) Bankruptcy Code provides that a court cannot confirm a plan unless at least one class of impaired claims approves the plan. Yet the US court ruled that "[i]t is appropriate to test compliance with section 1129(a)(10) on a per-plan basis, not […] on a per-debtor basis."

100 *Kamerstukken II* 2018/19, 35249, 3.

101 The same applies to the best-interest-of-creditors test, which prescribes the determination of liquidation value per entity, see section 3.5.

102 Rb. Amsterdam 2 September 2021, ECLI:NL:RBAMS:2021:6521, r.o. 10.8.

by the plan are fully compensated.[103] In other words, the present value of what is offered to the creditors is equal to the amount of the claims of those creditors.

The situation is different if the reorganisation value is insufficient to cover all debts. In this case, if a class votes against, it must be determined, upon request, whether that class receives its share of the reorganisation value of the relevant entity under the plan in line with the statutory waterfall. Given that the Dutch Bankruptcy Act requires compliance with the APR in respect of third parties (e.g. group guarantors), finding a justification for fully or partially releasing or amending a creditor's claim against the group guarantor while leaving shareholders of this guarantor unaffected is challenging. The strict application of the APR suggests that shareholders are not allowed to retain their shareholdings in the guarantor against the will of (classes of) creditors, as long as the creditors have not been paid in full.

One way to address the described problem is to arrange for the restructuring at the level of the parent company. If shareholders are wiped out at this top level, the issues caused by the APR can be resolved with relative ease. Another way is to argue that the value of shares in the third-party guarantor is zero, and therefore keeping the shareholders does not give them any value ahead of creditors. Whether this argument is accepted by the courts will depend, among other factors, on the interpretation of "value" under Article 384(4)(b) Fw – i.e., whether worthless shares could be considered "value" or not.[104] In our view, even if the equity interest in the guarantor does not have a positive present market value, the power to control it and the right to participate in the distribution of future profits may lead to the conclusion that the presently worthless equity can be of value.

Finally, it is worth noting that the Dutch APR is not strict and offers the following exception. When the distribution deviates from the statutory priority of claims (bankruptcy "waterfall"), to have the plan approved, the debtor needs to demonstrate: (i) the reasonable grounds for such deviation, and (ii) that the interests of the dissenting creditors are not harmed under the plan.[105] The meaning of what is regarded as "reasonable grounds" has

---

103 Rb. Amsterdam 3 November 2021, ECLI:NL:RBAMS:2021:6522, r.o. 9.17.

104 Note that the Dutch version of the APR refers to the distribution of "value" realised under the plan, whereas US law mentions "any property". In the past, some parties in US bankruptcy proceedings argued that the interest they had retained under the plan was valueless and therefore did not constitute property. However, this argument did not survive the scrutiny of the US Supreme Court in *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197 (1988).

105 Dutch Bankruptcy Act, Article 384(4)(b). R. van den Sigtenhorst, in: T&C Insolventierecht, commentaar op art. 384 Fw, observing with regard to the second requirement that it "can hardly be understood in any other way than a repetition of the best interest test concretely for those who object […]." See Rb. Den Haag 23 July 2021, ECLI:NL:RBDHA:2021:8121.

been left open. In a group context, consideration may be given to the total reorganisation value that can be generated or realised as a result of the group plan, which would otherwise be lost. Hence, for the purpose of determining the fairness of distribution, one may consider the total (group) reorganisation value and the *relative* entitlement of the creditor to such reorganisation value. The contribution to a plan by the guarantor's shareholders (new value exception) might also be taken into account.[106] In extreme cases, a holdout behaviour by a guaranteed creditor could be qualified as an abuse of rights.[107] That being said, we should keep in mind that abuse of rights is subject to a narrow interpretation and cannot offer a general solution to the given problem. In any case, the rigid application of the APR at the level of each group member involved in a WHOA plan can make the tool of third-party releases less appealing to enterprise groups. Perhaps, the safest option is to avoid cross-class cram down, if possible. Without it, the APR question does not arise.

10.3 Conclusions and Suggestions

10.3.1 Overview of main findings

Third-party releases are born out of commercial necessity. They synchronise legal responses to business and financing models, addressing the complexity of group interdependences facilitated by intra-group liability arrangements. They ensure a "single point of entry" to the resolution of group crises, thereby saving costs that would otherwise arise from multiple proceedings. But the significance of third-party releases extends far beyond simple cost-saving. It grants the liberating effect of debt alteration or discharge to third (non-debtor) parties. We will refer to this effect as the "extension effect". The economic benefits of a third-party release are clear.

106 N. Tollenaar, Pre-Insolvency Proceedings: A Normative Foundation and Framework, OUP, 2018, para. 6.97, observing that under the new value exception, shareholders can retain their investment, "even if dissenting senior classes are not fully satisfied, if in consideration for their retained interest they contribute new funds or new value that is at least equal to the value of their retained interest." For the discussion of new value exception, APR and the position of shareholders, see Rb. Midden-Nederland 31 March 2022, ECLI:NL:RBMNE:2022:1329, r.o. 4.42ff, *JOR* 2022/240, m.nt. R. van den Sigtenhorst, explaining that the possibility to deviate from the APR is that a shareholder may preserve a stake in the debtor if he acquires this stake at market price by contributing new money. Such a contribution must be in reasonable proportion to the value that is obtained or retained. In scrutinising the new money exception and the adequacy of shareholder contribution, the court considered the fact that no other party, including the dissenting creditor, was willing to provide the funds necessary to implement the restructuring.

107 Dutch Civil Code, Article 3:13. See HR 12 August 2005, *NJ* 2006/230 (*Groenemeijer/Payroll*); HR 24 March 2017, *NJ* 2017/466 (*Mondia/V&D*), dealing with the possibility to force one or several creditors to join the agreement proposed by the debtor out of court, where the majority of creditors have already agreed to the agreement, and the holdout creditor's behaviour is regarded an abuse of rights.

It safeguards the continuity of a group enterprise against the destabilising function of cross-guarantees. In the alternative, simultaneous enforcement of cross-entity obligations for the full amount may result in the destruction of enterprise value.

A good example of a case where parallel enforcement of debt pursuant to cross-entity liability arrangements greatly complicated a centralised group restructuring is Oi Brazil, introduced in section 1.1.3. This case featured an integrated cross-border group of companies with a complex centralised financing structure, involving special purpose financing entities in the Netherlands, guarantees extended by the parent and operating companies in Brazil, and intercompany loans. In a case like this, third-party releases – either at the level of operating companies or financing companies – could save costs, prevent conflicting judgments, accelerate group reorganisation, and thereby promote the preservation and maximisation of value.

However, the extension effect does not sit well with the traditional entity-by-entity approach to corporate insolvency. It also interferes with a personal security right, such as a guarantee, that rests on the idea of entity separateness. Thus, it implicates freedom of contract to the extent that it affects the rights of creditors against third parties and the obligations of these third parties. Non-consensual amendment or discharge of creditors' claims is an extraordinary feature of a restructuring or insolvency proceeding. Yet, in the case of a third-party release, these effects are achieved without opening such proceedings with respect to a third party benefiting from the release. Perhaps, this explains why third-party releases are controversial and are treated differently across jurisdictions.

English courts adhere to a pro-release approach and consider third-party releases a common practice in schemes of arrangement. The majority of English schemes deal with financial indebtedness, restructure group obligations, and are approved without any opposition. In contrast, US courts either completely disallow third-party releases, or permit them only in limited and "unusual" circumstances, not restricted to financial or intra-group indebtedness. This negative attitude to third-party releases is driven almost exclusively by their use in mass tort bankruptcies. The Dutch framework for extrajudicial restructuring plans (i.e. WHOA schemes), inspired by the two mentioned legal regimes, tailors third-party releases to resolve financial distress within enterprise groups and provides safeguards to protect affected creditors.

As indicated above, third-party releases may contribute to estate value preservation and maximisation. However, they can also disrupt the protective function of intercompany guarantees and other cross-liability arrangements. Any limitation of rights under these arrangements constitutes an interference with freedom of contract and party autonomy. A release

may also interfere with the principle of equal treatment of creditors and non-discrimination if substantive rights of a guaranteed creditor against a guarantor are altered (e.g. reduced or written down) under the plan, while non-guaranteed creditors do not lose such rights, for they never had them in the first place. A guaranteed creditor is treated differently (i.e. less favourably) compared to non-guaranteed creditors. Finally, if, as in the USA, the rules on third-party releases and their application are unpredictable, unclear and non-uniform, the protection of legitimate expectations of creditors is at stake.

The weakening of the protection afforded by intra-group guarantees, co-debtorship and collateral arrangements is likely to negatively affect the amount a guaranteed creditor can receive upon the debtor's default, potentially triggering its own financial distress and insolvency. The economic value of guarantees and other security arrangements is compromised, leading to an increase in the cost of credit and a reduction in the credit available to debtors.[108]

10.3.2 Suggestions on third-party releases in a group context

In pursuit of a balanced solution, the following suggestions can be made regarding third-party releases in a group context.

First, a third-party release should comply with the best-interest-of-creditors test. As we have pointed out in Chapters 3 and 4, this test protects creditor entitlements, promotes substantive fairness, and ensures protection of property rights. We argue that for a guaranteed creditor, this test should be applied with the existence of a claim against a third party in mind. This may necessitate the assessment of what the guaranteed creditor would have received if it were to proceed with a lawsuit against the guarantor, co-debtor or collateral provider. We propose to call this assessment the "group best-interest-of-creditors" test.

Admittedly, the application of the "group best-interest-of-creditors" test might face practical complications and require comprehensive disclosures from a non-debtor seeking to benefit from a release. Nevertheless, these are necessary sacrifices to ensure that a creditor is not deprived of the benefits afforded by a valid and effective personal or proprietary security arrangement. A valid claim against a third party is a property right that should not

108 P.M. Boyle, Non-Debtor Liability In Chapter 11: Validity of Third-Party Discharge In Bankruptcy, Fordham Law Review, Vol. 61, 1992, p. 443, noting that the "availability of the guarantee may reduce the cost of credit because the interest rate on loans will decrease as the risk of default decreases."

be taken away without adequate compensation.[109] This is precisely why a guaranteed creditor should not be worse off under the restructuring plan containing a third-party release, in comparison to an alternative, typically insolvency scenario, wherein the creditor maintains its right to sue the third party. We assert that any other solution risks being disproportionate and would effectively undermine the protective function of the relevant security arrangement. This suggestion aims to safeguard the value of the existing creditor entitlements, promote substantive fairness, and ensure the protection of property rights.

Second, given the diversity of groups, their financial arrangements and crisis situations, it is impossible to come up with a simple bullet-proof and universal formula that would determine whether a third-party release is desirable or justified. Instead, we identify circumstances where the case for third-party releases is strong, and where it is weak.

The case for approving a third-party release is stronger when:

- A third-party release is consensual. If the creditor consents to a release, a third-party release should not raise any objections. It is in line with party autonomy and per se does not negatively affect the insolvency estate or the rights of other creditors.
- A third-party release relates to a derivative claim – a claim that belongs to the debtor and is not an independent claim of the creditor. Claims under cross-guarantees, co-debtorship and other intra-group liability arrangements do not qualify as derivative claims, as they belong to a guaranteed creditor and not the debtor.
- A third party, such as a surety or guarantor, can file a recourse claim (e.g. indemnity or *regres*) in the full amount against the debtor, potentially undermining the success of its restructuring efforts. This is what we call the "ricochet problem", described in Chapter 6. If not addressed, this problem can lead to a failed restructuring and reduced estate value.
- A third-party release is a constituent part of a purely financial restructuring involving sophisticated parties. Well-informed, sophisticated and strongly adjusting creditors are better positioned to diversify their risks and be advised by professional advisors. As a result, any conflicts between weak and strong creditors are less likely to occur, making concerns about the fairness and foreseeability of a third-party release in a purely financial restructuring less salient.

---

109 J.L. Schroeder, D.G. Carlson, Third Party Releases Under the Bankruptcy Code After Purdue Pharma, American Bankruptcy Institute Law Review, Vol. 31, 2023, p. 3, arguing that a release of creditors' claims against third parties "constitutes an expropriation of property owned by individual creditors." The authors refer to reorganisation plans that contain this type of releases, and which do not provide for adequate compensation, as "theft plans".

- An enterprise group is integrated, and the likely failure of a third party resulting from the enforcement of a guarantee will have a significant detrimental effect on the debtor's own survival. This is the case where the group member benefitting from a release plays an important role within the anchor debtor's group of companies or is an integral part of the anchor debtor's restructuring. Any failure to address this may lead to the "orphan restructuring problem", described in Chapter 6. In essence, the orphan restructuring problem harms the principle of estate value preservation and maximisation (as applied to a group context, see section 4.4.1.), which this suggestion seeks to promote.
- A third-party release is necessary to facilitate efficient, speedy, and cost-effective group restructuring. It can be a useful strategy, especially when dealing with an international enterprise group, like Oi Brazil, where the opening of multiple proceedings against its members in different countries significantly complicates a centralised group solution, leading to excessive costs, substantial delays, holdout behaviour and even conflicting judgments.

By contrast, the need for a third-party release may be called into question when:

- None of the elements mentioned above are present.
- A third party is not financially distressed and does not become financially distressed as a result of the enforcement of the guarantee or collateral. If the third party is solvent and liquid and can pay the debt without getting insolvent or illiquid, the case for a third-party release is weaker. Discharging the liability of a guarantor, co-debtor or collateral provider solely because the principal or scheme debtor is in financial distress and unable to satisfy the creditor's claim in full is difficult to justify in principle. Interference with contractual rights is hard to substantiate if the guarantor, co-debtor, or collateral provider is not experiencing financial distress or insolvency. In such a case, the protection of legitimate expectations, freedom of contract and party autonomy should prevail.
- The case entails a piecemeal liquidation and does not pursue business preservation, regardless of whether the liquidation is achieved via a Chapter 11 plan or WHOA plan. In a piecemeal liquidation scenario, the need to preserve the debtor's going concern value is absent, and therefore, a third-party release – being first and foremost a restructuring tool aimed at business preservation – is less necessary. It is important to note that business preservation does not necessarily require the preservation of business within current companies and could be achieved through a business sale.

Third, the strict application of certain national rules can create roadblocks to the efficient use of third-party releases. We discussed some of them in the above sections on WHOA schemes and demonstrated that the scope of

these rules might not allow third-party releases when the guarantors are not a part of the debtor's group or when they provide separate guarantees securing debts of each other. Other potential problems relate to the conditions for third-party releases, such as the requirements to have at least one supporting class of creditors and adhere to the APR for every group entity involved (including released entities). If both requirements must be satisfied with respect to a third party, whose obligations are being subject to the amendment or release, a class of guaranteed creditors, in fact, acquires a veto right. This outcome can make third-party releases less practical or even unworkable outside consensual plans. The need for law to be applied in a commercially sensible way, particularly in financial restructuring cases, in our view, justifies a flexible application of certain rules and special consideration given to group reorganisation value. However, the key safeguard of the group best-interest-of-creditors-test should remain in full force.

11 Insolvency Stay on Creditor Action and its Extension to Group Entities▪

11.1 Introduction

A stay of individual enforcement actions and the replacement of such actions with a collective enforcement process are among the cornerstones of modern insolvency law. They aim to preserve the value of the insolvency estate and facilitate its efficient administration.[1] Hence, a stay effectively addresses the common pool problem. Jackson explains that:

> To the extent that a non-piecemeal collective process (whether in the form of liquidation or reorganization) is likely to increase the aggregate value of the pool of assets, its substitution for individual remedies would be advantageous to the creditors as a group. This is derived from the commonplace notion: that a collection of assets is sometimes more valuable than the same assets would be if spread to the winds. It is often referred to as the surplus of a going concern value over a liquidation value.[2]

A stay plays an equally important role in proceedings aimed at rescuing ailing companies, as it provides the debtor with a breathing space, safeguards its going concern value, and strengthens its position in negotiations with creditors.[3] Without a stay, creditors could seize assets essential for carrying out the business, thereby jeopardising any prospects for a successful restructuring. By blocking actions of individual creditors that can frustrate restructuring efforts, even if these efforts are supported by the majority

---

▪ This chapter builds upon the following previously published work by the author:
– I. Kokorin, Promotion of group restructuring and cross-entity liability arrangements, Journal of Corporate Law Studies, Vol. 21, 2021, pp. 557-593.e Groups, European Company and Financial Law Review, Vol. 18, 2021, pp. 107-140.

1 UNCITRAL Legislative Guide on Insolvency Law, Part two, 2004, Ch. II, para. 26; O. Couwenberg, S.J. Lubben, Essential Corporate Bankruptcy Law, EBOR, Vol. 16, 2015, p. 49; T.H. Jackson, The Logic and Limits of Bankruptcy Law, Harvard University Press, 1986, p. 14.

2 T.H. Jackson, The Logic and Limits of Bankruptcy Law, Harvard University Press, 1986, p. 14.

3 See H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 340 (1977), noting that a stay "gives the debtor a breathing spell from his creditors. It stops all collection efforts, all harassment, and all foreclosure actions. It permits the debtor to attempt a repayment or reorganization plan, or simply to be relieved of the financial pressures that drove him into bankruptcy."

of creditors, a stay mitigates the anti-commons problem.[4] Whereas the commons problem deals with the collective action problem linked to the numerosity of creditors and the difficulty of coordinating actions between them, the anti-commons problem is premised on fragmented and conflicting interests of such creditors.[5] In addition to preserving the value of the insolvency estate, a stay also ensures equality of distribution among creditors (*paritas creditorum*) by preventing the grab race, which would result in some creditors always winning and others always losing.[6]

The importance of a stay is emphasized by various standard setting organisations, including the World Bank,[7] UNCITRAL,[8] FSB[9] and EBRD.[10] The Restructuring Directive acknowledges that a "debtor should be able to benefit from a temporary stay of individual enforcement actions, […] with the aim of supporting the negotiations on a restructuring plan, in order to be able to continue operating or at least to preserve the value of its estate during the negotiations."[11]

This chapter discusses the stays available to companies in financial distress. It is no coincidence that this chapter follows the chapter on third-party releases. A stay – when extended to group guarantors, co-debtors, or collateral providers – ensures the effectiveness of a third-party release. But even without such a release, it may be employed to address the problems created by the triangle of rights and liabilities (see Chapter 6), even if temporarily.

---

4 On the problem of holdouts and the tragedy of anti-commons in insolvency and restructuring, see R.J. de Weijs, Harmonisation of European Insolvency Law and the Need to Tackle Two Common Problems: Common Pool and Anticommons, International Insolvency Review, Vol. 21, 2012, pp. 67-83. See, generally, M.A. Heller, The Tragedy of the Anticommons: Property in the Transition from Marx to Markets, Harvard Law Review, Vol. 111, 1998, pp. 621-688.

5 D.G. Baird and R.K. Rasmussen, Antibankruptcy, The Yale Law Journal, Vol. 119, 2010, p. 648.

6 See, however, B. Wessels, S. Madaus (eds), Rescue of Business in Europe: A European Law Institute Instrument, OUP, 2020, p. 195, observing that "a stay does not primarily serve to guarantee equal treatment of creditors, but rather serves to protect the realisation of the intention of the debtor to restructure its business."

7 World Bank, Principles for Effective Insolvency and Creditor/Debtor Regimes, 2021, C5, stating that the "injunctive relief (stay) should be as wide and all-encompassing as possible, extending to an interest in assets used, occupied, or in the possession of the debtor."

8 UNCITRAL Legislative Guide (2004), Part two, Ch. II, para. 26ff.

9 FSB Key Attributes of Effective Resolution Regimes for Financial Institutions, 2014, KA 3.2. referring to the power of resolution authorities to impose a stay on creditor actions to attach assets or otherwise collect money or property from a bank, and the power to temporarily stay the exercise of early termination rights that may otherwise be triggered upon entry of a bank into resolution.

10 EBRD Core Principles of an Effective Insolvency System, September 2020, Principle 6.

11 Restructuring Directive, Recital 32, Articles 6 and 7.

This chapter proceeds as follows. First, we describe the main features of how a stay is regulated in the chosen national legal systems (section 11.2.). This study demonstrates that the availability, design and scope of a stay vary between jurisdiction, and sometimes also within the same jurisdiction, depending on the applicable procedure. For instance, in the UK, an automatic stay applies in administration but is not available in schemes of arrangement or CVAs. Besides, a stay binds secured creditors in administration, but not in liquidation. Secured creditors are generally unaffected by bankruptcy under Dutch law. In contrast, under US bankruptcy law, a wide-ranging stay is automatically imposed on both secured and unsecured creditors. Second, since this book primarily focuses on group financial arrangements, we explore whether an enforcement stay could be given an extension effect. In other words, we look into the personal scope of a stay and examine whether it can be extended to cover third parties, such as group entities acting as guarantors, co-debtors and collateral providers (section 11.3.), even if they are not themselves subject to an insolvency or restructuring proceeding. Section 11.4. contains suggestions on when a group-wide extension of a stay may be desirable.

11.2 Enforcement Stays in National Law

11.2.1 The UK: patchwork of different rules and procedures

The rules on enforcement stays are found in the laws of many jurisdictions. However, the scope of these rules, and the mode of their operation (e.g. automatic vs. non-automatic, general stay vs. selective stay, length of a stay) vary depending on the type of procedure or the creditor concerned.[12]

English law is not homogeneous. It contains a menu of procedures that can be used in a situation of financial distress. Among them are winding up by the court, administration, administrative receivership, CVAs, and more recently, a standalone moratorium. While these procedures are part of the Insolvency Act 1986, schemes of arrangement, often relied on to restructure debts of financially distressed firms, are governed by the Companies Act 2006. The existence, purpose and scope of a stay depend on the applicable procedure. For example, differences can be observed between a liquidation stay applicable upon making a winding-up order[13] and an administration stay applicable during administration.[14] The former "is designed to avoid the unnecessary expenditure of assets otherwise available for distribu-

12 G. McCormack, A. Keay, S. Brown, J. Dahlgreen, Study on a new approach to business failure and insolvency, 2016, pp. 230-231.
13 Insolvency Act 1986, sec. 130(2).
14 Insolvency Act 1986, Schedule B1, para. 43.

tion amongst creditors and to support the replacement of a creditor's right to establish a claim by judgment in an action with a right to lodge a proof of debt."[15] A liquidation stay does not affect the right of a secured creditor to enforce security, as well as other real rights. This is based on the understanding that the purpose of liquidation is not rehabilitation but the disposal of the debtor's assets and the distribution of proceeds among creditors.[16] By contrast, administration imposes a statutory moratorium on the enforcement of most types of claims, including secured ones.[17] Therefore, no steps may be taken to enforce security over the debtor's property except with the consent of an administrator or court permission.[18] This promotes the preservation of the debtor's business as a going concern. Nevertheless, historically, administration in the UK has been associated with the end of the reorganisation prospects.[19]

The CIGA introduced a new, stand-alone moratorium procedure aimed at providing the debtor with a breathing space to explore its restructuring options free from creditor action.[20] Its scope is broadly similar to an administration stay, with some differences. When a company invokes a moratorium, it is entitled to a "payment holiday" for its pre-moratorium debt, which includes both (i) debts that were due before the moratorium, and (ii) debts that fall due during the moratorium but arose from obligations incurred before the moratorium.[21] Certain debts are excluded from the moratorium, such as the monitor's remuneration or expenses, amounts payable for goods or services supplied during the moratorium, rent for a period during the moratorium, and wages or salary arising from a contract of employment.[22] While the "payment holiday" in principle extends to both unsecured and secured creditors,[23] it does not apply to "debts […] arising under a contract or other instrument involving financial services."[24]

15 *Gardner v. Lemma Europe Insurance Company Ltd* [2016] EWCA Civ 484, at 2.

16 *Heis & Ors (Administrators of MF Global UK Ltd.) v. MF Global Inc.* [2012] EWHC 3068 (Ch), at 33.

17 Administration does not affect enforceability of a security interest under a financial collateral arrangement. See Regulation 8(1)(a), Financial Collateral Arrangements (No. 2) Regulations 2003.

18 Insolvency Act 1986, Schedule B1, para. 43.

19 S. Paterson, Corporate Reorganization Law and Forces of Change, OUP, 2020, p. 239.

20 Insolvency Act 1986, Part A1. Between 26 June 2020 and 30 June 2023, in England and Wales, 45 moratoriums were obtained. See Official Statistics. Monthly Insolvency Statistics, June 2023, released on 18 July 2023.

21 Insolvency Act 1986, Part A1, Ch. 4, s. A18(3).

22 Ibid.

23 In addition, a moratorium imposes a restriction on the enforcement of security over the debtor's property, subject to specified exceptions (e.g. financial collateral). See Insolvency Act 1986, Part A1, Ch. 4, s. A21(1)(s).

24 Insolvency Act 1986, Part A1, Ch. 4, s. A18(3).

This exclusion covers loan agreements.[25] Consequently, unless the lender consents to a payment holiday, the debtor must continue making payments under a loan agreement, regardless of whether the payment obligation arises before or after the start of the moratorium. This may reduce the attractiveness of the moratorium procedure in practice.[26]

As opposed to the above procedures, which in one way or another encompass a stay, such a stay is not prescribed by the Companies Act 2006. Neither schemes of arrangement (Part 26) nor restructuring plans (Part 26A) give the debtor a break. The absence of a stay leaves the company exposed to creditor actions during the period when the proposed restructuring is negotiated and implemented. This exposure is not insignificant, considering that it may take at least eight weeks between the proposal of a scheme and its sanctioning by the court.[27] In some cases, courts have recognised their jurisdiction to order a stay of proceedings initiated by a creditor against the debtor to recover debt, pending the implementation of a scheme of arrangement. This jurisdiction was based on the UK Civil Procedure Rules (CPR) and the court's case management powers.[28] Additionally, a scheme of arrangement or a restructuring plan could be accompanied by a freestanding moratorium (Part A1), which can support the negotiation of a scheme or a restructuring plan. Yet, as noted above, this moratorium does not apply to contracts involving financial services. Alternatively, a standstill agreement may be entered into with a selected group of creditors (e.g. financial creditors). A standstill agreement is a useful contractual solution, especially for situations where creditors are not numerous and have homogenous interests.

---

25 Insolvency Act 1986, Schedule ZA2. See *Minor Hotel Group MEA DMCC v. Dymant & Anor* [2022] EWHC 340 (Ch), at 14, observing that the "exclusion of finance debts from the "payment holiday" effects of a moratorium is somewhat surprising: but is the clear meaning of the amended Act."

26 J. Payne, An Assessment of the UK Restructuring Moratorium, Lloyd's Maritime and Commercial Law Quarterly, 2021, p. 465, explaining that "for the moratorium to be fully effective the company will need to have the support of its lenders, and possibly enter into some form of waiver or standstill agreement with them."

27 J. Payne, Schemes of Arrangement: Theory, Structure and Operation, CUP, 2021, p. 239.

28 *BlueCrest Mercantile BV v. Vietnam Shipbuilding Industry Group* [2013] EWHC 1146 (Comm). The court stated that the scheme of arrangement had a reasonable prospect of success, and relied on CPR, Rule 3.1(2)(f). Under this rule, the court has the power to "stay the whole or part of any proceedings or judgment either generally or until a specified date or event." *Sea Assets Ltd v. PT Garuda Indonesia*, 27 June 2001, unreported. Another case where the CPR were relied on to order a stay is *Riverside CREM 3 Ltd v Virgin Active Health Clubs Ltd* [2021] EWHC 746 (Ch), at 34, establishing that the "process under Part 26A should be permitted to proceed without being impeded by a judgment being entered or enforced."

The last procedure worth mentioning is a company voluntary arrangement (CVA),[29] due to its value as a debt restructuring mechanism.[30] If a CVA runs in parallel with a winding-up or administration, it benefits from the statutory moratorium. Besides, prior to the CIGA, the law allowed directors of "eligible companies" to take steps to obtain a moratorium if they intended to make a proposal for a CVA – a so called small company moratorium.[31] It was available to companies that satisfied certain criteria related to turnover, balance sheet, or the number of employees.[32] The small company moratorium regime was not widely used,[33] and was replaced by the CIGA with a standalone moratorium procedure, discussed above. Outside these special cases, entry into a CVA does not attract a moratorium. In the absence of a moratorium, a CVA can alter obligations and impose new payment terms, so that creditors would only be able to institute any action if these terms have not been complied with by the debtor.[34] However, any creditors not bound by the CVA do not have such restrictions and would, therefore, be able to institute any type of action based on their claims.

Describing corporate reorganisation toolbox in the UK and the USA, Paterson emphasises the striking difference between "relative weakness of available moratorium (or stay) protection in English corporate reorganization law when compared with the US."[35] The following section examines the scope and operation of an automatic stay under US bankruptcy law.

29 Insolvency Act 1986, Part I.

30 See e.g. *Discovery (Northampton) Ltd v. Debenhams Retail Ltd* [2019] EWHC 2441 (Ch). Note, however, that a CVA does not bind preferential and secured creditors without their consent. Insolvency Act 1986, section 4.

31 Insolvency Act 1986, Schedule A1 (abolished by the CIGA).

32 Ibid. Section 382(3), Companies Act 2006. I. Fletcher, The Law of Insolvency, 5th edn, Sweet & Maxwell, 2017, paras. 15-054 to 15-059.

33 P. Walton, C. Umfreville and L. Jacobs, A snapshot of company voluntary arrangements: Success, failure and proposals for reform, International Insolvency Review, Vol. 29, 2020, p. 269.

34 On this point, it has been noted that a moratorium is "an almost universal feature of a concluded CVA, although its effect is confined to those bound by the CVA." K. van Zwieten, Goode on Principles of Corporate Insolvency Law, 5th edn, Sweet & Maxwell, 2018, para. 11-54. See also J. Payne, Schemes of Arrangement: Theory, Structure and Operation, OUP, 2014, p. 216, observing that "a CVA will only have this effect [a stay] if its terms so provide. Without such a term any creditor, even one bound by a CVA, is free to pursue his claims by action, whereas with such a term, creditors bound by the CVA are not free to pursue their claims, save for those creditors outside the CVA (e.g. the secured creditors)."

35 S. Paterson, Corporate Reorganization Law and Forces of Change, OUP, 2020, p. 239.

11.2.2 The USA: broad automatic and worldwide stay

The filing of a bankruptcy petition in the USA automatically opens the bankruptcy case and triggers a worldwide stay binding on the debtor's creditors, whether secured or unsecured. The stay is akin to a statutory injunction, as a result of which "[i]nstead of an uncontrolled self-help scramble for the debtor's assets, creditor claims must be dealt with in an orderly manner under the supervision and control of the bankruptcy court."[36] Actions carried out in violation of a stay – whether or not a party had knowledge of the bankruptcy filing – are deemed void *ab initio*,[37] and, when intentional, may be punishable as contempt of court.

The stay covers the commencement or continuation of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before a Chapter 11 case, or the recovery of a claim against the debtor that arose before the commencement of the case.[38] Importantly, a claim arises at the time when the obligation is incurred, and not when it is due.[39] Lawsuits based on post-petition claims are not stayed unless the debtor receives injunctive relief from the bankruptcy court. The stay precludes creditors from enforcing pre-petition judgments, perfecting or enforcing pre-petition liens, foreclosing on collateral, terminating executory contracts on account of pre-petition default (i.e. executory contracts are considered a form of property of the estate), setting-off pre-petition debts arising from different transactions, etc.[40] In sum, the automatic stay is extensive and normally remains in place for the whole duration of the bankruptcy procedure.[41]

There are myriad exceptions to the automatic stay. They include, inter alia, enforcement by a governmental unit of a "police and regulatory power", including protection of public health, safety and welfare,[42] commencement or continuation of a criminal action or proceeding against the debtor,[43] and the exercise of contractual rights under various financial contracts (e.g. repos, commodity contracts, forward contracts, securities contracts, swap

36 C.J. Tabb, Law of Bankruptcy, 4th edn, West Academic Publishing, 2016, p. 235.
37 A minority of courts holds view that acts taken in violation of the stay are voidable. See e.g. *In re Coho Res., Inc.*, 345 F.3d 338, 344 (5th Cir. 2003).
38 11 U.S. Code § 362(a)(1). For the broad definition of a "claim" see § 101(5).
39 Collier on Bankruptcy, 16th edn, 2022, Vol. 3, ¶ 362.03[3][a].
40 11 U.S. Code § 362(a)(2)-(8).
41 11 U.S. Code § 362(c)(2).
42 11 U.S. Code § 362(b)(4). Note that the police power exception in principle does not affect the stay applicable to the enforcement of a money judgment even if it is connected to the government's police and regulatory powers.
43 11 U.S. Code § 362(b)(1).

agreements).[44] As noted previously, parties to these contracts enjoy the privilege to the extent that they are not limited in exercising their right "to cause the liquidation, termination, or acceleration" of the contract by the prohibition of ipso facto clauses.

Unlike a liquidation stay in the UK or as further discussed below, a stay in Dutch bankruptcy and suspension of payments procedures, a stay under the US Bankruptcy Code binds secured creditors. In specific circumstances, a secured creditor can request relief from the stay. In fact, motions related to stay relief are one of the most common forms of litigation in bankruptcy procedures.[45] The law stipulates that:

> On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under subsection (a) of this section, such as by terminating, annulling, modifying, or conditioning such stay -
> (1) for cause, including the lack of adequate protection of an interest in property of such party in interest;
> (2) with respect to a stay of an act against property under subsection (a) of this section, if -
> (A) the debtor does not have an equity in such property; and
> (B) such property is not necessary to an effective reorganization;[46]

This provision aims to establish a balance between the interests of a debtor and unsecured creditors in a reorganisation process, on the one hand, and the interests of secured creditors and other property rights holders, on the other hand. If the value of the collateral is diminishing during a stay, the interests of a secured creditor are affected and require adequate protection. Conversely, the absence of any decline in the value of collateral might be regarded as a lack of impairment of the creditor's rights, indicating that these rights being adequately protected.

---

44 11 U.S. Code § 362(b)(6), (7), (17), (27). A.J. Levitin, Business Bankruptcy: Financial Restructuring and Modern Commercial Markets, Wolters Kluwer, 2016, p. 266, noting that the "anti-forfeiture principle and the general policy of favoring reorganization are not limitations on financial contract creditors" and that their exemption from a stay "is essentially the ultra super-priority." Also, S.J. Lubben, Subsidizing Liquidity or Subsidizing Markets: Safe Harbors, Derivatives, and Finance, American Bankruptcy Law Journal, Vol. 91, 2017, p. 472, observing that "the bankruptcy court has no ability to stay the exercise of safe harbor rights or the commencement of closeout netting."

45 C.J. Tabb, Law of Bankruptcy, 4th edn, West Academic Publishing, 2016, p. 285.

46 11 U.S. Code § 362(d).

"Adequate protection" is a flexible concept that should be assessed against the facts and circumstances of each case.[47] The aim of guaranteeing adequate protection as a prerequisite for the continuation of an automatic stay is to ensure that a creditor receives the value for which he has bargained pre-bankruptcy.[48] This is derived from the property interest protections found in the Fifth Amendment to the US Constitution.[49] In practice, adequate protection comes in a variety of forms. It may take the form of cash payments (lump sum or, more commonly, periodic) offsetting depreciation of the property's value, as well as additional or replacement collateral. A secured creditor is entitled to the protection of the collateral value and not of the rights in a specific asset given as collateral.[50] Arguably, in many cases, a distressed debtor lacks the necessary liquidity and unencumbered assets to offer as collateral. This is why the third means of adequate protection becomes particularly important. Namely, adequate protection could consist of "granting such other relief […] as will result in the realization by such entity of the indubitable equivalent of such entity's interest in such property."[51]

The US Bankruptcy Code does not define "indubitable equivalent".[52] The phrase originated in the context of a plan cram-down, where it is used to refer to the "unquestionable value of a lender's secured interest in the collateral."[53] This "catch-all" phrase gives the courts significant flexibility and discretion to determine what protection is appropriate in a given situation. Some courts have found that adequate protection can be accomplished through: (i) the existence of an equity cushion shielding the interests of a

---

47 H. Rep. No. 595, 95th Cong., 1st Sess. 343-4 (1977), U.S.Code Cong. & Admin.News 1978, p. 5787. See also *In re Alyucan Interstate Corp.*, 12 B.R. 803 (Bankr. D.Utah 1981); *In re Bushee*, 319 B.R. 542, 551 (Bankr. E.D. Tenn. 2004), noting that the "determination of whether a creditor's interest is adequately protected is not an exact science nor does it involve a precise arithmetic computation. Rather, it is pragmatic and synthetic, requiring a court to balance all relevant factors in a particular case, including the value of the collateral, whether the collateral is likely to depreciate over time, the debtor's prospects for a successful reorganization and the debtor's performance under the plan. Other considerations may include the balancing of hardships between the parties and whether the creditor's property interest is being unduly jeopardized."

48 *In re DB Capital Holdings, LLC*, 454 B.R. 804, 816-17 (Bankr. D.Col. 2011); *In re O'Connor*, 808 F.2d 1393, 1396 (10th Cir.1987).

49 *Wright v. Union Central Life Ins. Co.*, 311 U.S. 273 (1940). See, however, C.J. Tabb, The Bankruptcy Clause, the Fifth Amendment, and the Limited Rights of Secured Creditors in Bankruptcy, University of Illinois Law Review, Vol. 2015, 2015, pp. 765-809, arguing that the Fifth Amendment is not relevant in considering the constitutional rights of secured creditors in bankruptcy.

50 *Wright v. Union Central Life Ins. Co.*, 311 U.S. 273 (1940).

51 11 U.S. Code § 361.

52 The phrase "indubitable equivalent" has its genesis in the opinion of Judge Learned Hand, writing for the court in *In re Murel Holding Corporation*, 75 F.2d 941 (2nd Cir.1935). For the background of this phrase, see *In re Colrud*, 45 B.R. 169 (Bankr. D. Alaska 1984).

53 *In re Philadelphia Newspapers, LLC*, 599 F.3d 298, 310 (3d Cir. 2010).

secured creditor from loss due to a decrease in the property's value,[54] (ii) a third-party guarantee,[55] and (iii) the maintenance of insurance on a creditor's collateral or leased property, protecting the collateral against loss or depreciation.[56] Notably, granting administrative priority to a claim does not constitute adequate protection, as "such protection is too uncertain to be meaningful."[57]

The preceding paragraphs discussed relief from the automatic stay "for cause", such as due to the lack of adequate protection of an interest in property. If the equity cushion is found to be adequate or the debtor is able to provide an alternative means of adequate protection, relief from the stay can nevertheless be granted to a creditor, provided that the requirements of the second test of § 362(d) of the US Bankruptcy Code are met. Under this test, a stay shall be lifted if: (i) the debtor has no equity in the property of the bankruptcy estate, *and* (ii) this property is not necessary for an effective reorganisation.[58] Both requirements must be met. To satisfy the first requirement, the value of the property should not exceed the debts secured by all liens and other encumbrances on such property.[59] Valuation is determined case-by-case, taking into account the nature of the debtor's business, market conditions, the debtor's prospects for rehabilitation, and the type of collateral. If the debtor maintains equity in the property, a stay cannot be lifted under this provision. But even if the debtor lacks such equity, a stay relief will be denied if the debtor needs the property in question for a successful reorganisation. To satisfy this requirement, the debtor must show that the property is essential for an *effective* reorganisation that is in prospect.[60] This means that there must be "a reasonable possibility of a suc-

54 *In re Norton*, 347 B.R. 291, 298 (Bankr. E.D. Tenn. 2006); *In re Mellor*, 734 F.2d 1396, 1400 n. 2 (9th Cir. 1984); *In re Roane*, 14 B.R. 542 (E.D. Pa. 1981). The equity cushion of 20% or more is usually deemed to be sufficient by courts. An equity cushion of 0% to 11% has generally been held insufficient, and case law is divided on whether a cushion of 12% to 20% constitutes adequate protection. For a summary of case law, see *In re Big Dog II, LLC*, 602 B.R. 64 (Bankr. N.D.Fla. 2019).

55 *In re Harrow Leasing Corp.*, 35 B.R. 916 (Bankr. E.D.Pa. 1983); *In re Swedeland Dev. Group, Inc.*, 16 F.3d 552, 564 (3d Cir. 1994), noting that the sufficiency of a guaranty would depend on the financial strength of the guarantor. However, *In re C.F. Simonin's Sons, Inc.*, 28 B.R. 707, 712 (Bankr. E.D.N.C. 1983), holding that "[e]ven if there was undisputable evidence of the creditworthiness of the guarantors, the chance to pursue a guarantor with its uncertainties and costs is not adequate protection."

56 *In re Powell*, 223 B.R. 225, 234 (Bankr. N.D. Ala. 1998), stating that "adequate protection may include providing proof of an enforceable insurance policy on the collateral and/or proof of proper maintenance of the property."

57 S. Rep. No. 95-595, 95th Cong., 2d Sess., at 54 (1978).

58 11 U.S. Code § 362(d)(2).

59 *In re Garsal Realty, Inc.*, 98 B.R. 140 (Bankr. N.D.N.Y. 1989); *Sutton v. Bank One, Texas, Nat'l Ass'n*, 904 F.2d 327 (5th Cir.1990).

60 *In re HSD Partners, LLC*, 451 B.R. 636, 638 (Bankr. S.D. Ga. 2011), noting that for property to be necessary to an effective reorganization, it must be "logically required for a reorganization which has a reasonable possibility of succeeding within a reasonable time."

cessful reorganization within a reasonable time"[61] (feasibility) and that the property in question is necessary for this reorganisation (necessity). If the relief from a stay is requested at the early stages of bankruptcy, the burden upon the debtor tends to be less stringent. As the case progresses, this burden becomes heavier.[62]

In sum, a stay on creditor actions under the US Bankruptcy Code is distinguishable from that available in the UK. Unlike the complex puzzle of procedures and tools found in the Insolvency Act 1986 and the Companies Act 2006, some of which do not provide for a stay, US Chapter 11 acts as a single gateway to corporate restructurings. It offers an automatic and extensive stay that precludes the commencement and continuation of proceedings aimed at recovery on a pre-petition claim, as well as collection and foreclosure actions of debtor's creditors, including secured ones. Nevertheless, it seeks to maintain a balance by granting secured creditors the right to request relief from an automatic stay. This contributes to the growing influence of secured creditors over firms in bankruptcy. The following section will show that Dutch law is even more protective of the interests of secured creditors.

11.2.3 The Netherlands: moratoriums and cooling-off periods

In the Netherlands, as in the UK and the USA, there is no statutory stay in an out-of-court workout. In this section, we discuss three relevant statutory procedures found in the Dutch Bankruptcy Act, namely: (i) suspension of payments (*surseance van betaling*); (ii) bankruptcy (*faillissement*); and (iii) WHOA scheme or plan (*onderhands akkoord*), introduced in section 3.3.3.

The suspension of payments provides for a stay or moratorium (*schorsing van executie*) that is effective from the day on which a suspension of payments is (provisionally) granted. As a result, the debtor cannot be forced to pay debts in respect of which the suspension is effective, and all executions initiated to recover such debts are suspended.[63] This applies not only to the payment of a sum of money but also includes, in line with Article 6:30 BW, every form of satisfaction in the broadest sense.[64] The stay applies to both pre-filing claims and claims arising from a legal relationship that already

61 *United Savings Ass'n v. Timbers of Inwood Forest Associates, Ltd.*, 484 U.S. 365, 98 L. Ed. 2d 740, 108 S. Ct. 626 (1988).

62 *Matter of Holly's, Inc.*, 140 B.R. 643 (Bankr. W.D. Mich. 1992); *In re Ashgrove Apartments of DeKalb County, Ltd.*, 121 B.R. 752 (Bankr. S.D. Ohio 1990); *In re Brian Wise Trucking, Inc.*, 386 B.R. 215 (Bankr. N.D. Ind. 2008).

63 Dutch Bankruptcy Act, Article 230(1).

64 HR 23 October 1981, *NJ* 1982/173, m.nt. B. Wachter (*Gemeente Heiloo/Orthopedagogisch Centrum Noord-Holland c.s.*); Rb. S'-Hertogenbosch 20 October 2010, *JOR* 2011/28, m.nt. W.J.M. van Andel, concerning an obligation to provide a bank guarantee.

existed at the time of the filing.[65] It is important to note that the stay is only effective against unsecured creditors and only lasts as long as the suspension remains in effect.[66] Thus, it does not bind creditors with priority.[67] Priority arises from a pledge, mortgage, privilege, or other grounds laid down in the law.[68] Insofar as a claim cannot be recovered from the goods on which the priority rests, such a claim is subject to a stay. Some authors have cited the fact that priority claims, especially secured claims, remain unaffected by the stay as one of the primary reasons why the suspension of payments is considered an inefficient reorganisation procedure, often acting as a gateway to bankruptcy.[69]

Dutch law grants the possibility to acquire protection against secured creditors. It states that upon the request of an interested party or *ex officio*, the court may declare a cooling-off period or *afkoelingsperiode*, during which any power to recover from the insolvency estate or to claim assets that are in the debtor's control, cannot be exercised except with the authorisation of the court or (if appointed) a supervisory judge (*rechter-commissaris*).[70] A cooling-off period can be granted for a period of up to two months, with a possible extension once again for a maximum of two months. This aligns with the objectives of the suspension of payments, as this procedure primarily aims at ensuring the continuity of the debtor's business. Yet the limited duration of a cooling-off period is based on the understanding that it constitutes a significant limitation of (secured) creditors' rights.[71] The court has the authority to restrict the application of a cooling-off period to certain creditors and attach specific conditions thereto.[72]

---

65 Ibid. HR 19 April 2013, *NJ* 2013/291, m.nt. F.M.J. Verstijlen (*Koot Beheer/Tideman qq*); HR 23 March 2018, *NJ* 2018/290, m.nt. F.M.J. Verstijlen (*Credit Suisse Brazil (Bahamas)/Jongepier qq*). This interpretation also follows from Article 233 Fw.

66 In principle, the provisional suspension of payments (and its stay) is first granted for a period of two months, with one extension of up to two more months. Within this period, creditors must be consulted by the court to reassess the validity of the suspension of payments. See Article 215 Fw and the National procedural regulations in bankruptcy cases (*Landelijk procesreglement verzoekschriftprocedures insolventiezaken rechtbanken*), 1 July 2023, at 2.3.1. When a court grants a final suspension of payments, this is for a maximum of 1,5 years. Before the expiration of this period, the debtor can request an extension for a maximum of 1,5 years once or several times. The court will reassess every time whether the debtor still qualifies for the suspension of payments. Article 223(2) Fw.

67 Dutch Bankruptcy Act, Article 232.

68 Dutch Civil Code, Article 3:278(1).

69 R.J. van Galen, De surseance als echte reorganisatieprocedure, TvI 2015/23, p. 151-152; R.D. Vriesendorp, Insolventierecht, 2e druk, Deventer: Wolters Kluwer, 2021.

70 Dutch Bankruptcy Act, Article 241(a)(1). Note that the exception is made for *boedelschuldeisers* – creditors with post-commencement or estate claims. HR 19 April 2013, ECLI:NL:HR:2013:BY6108, *NJ* 2013/291, m.nt. F.M.J. Verstijlen (*Koot Beheer/Tideman*). Also, B. Wessels, Vereffening van de boedel (Wessels Insolventierecht nr. VII), 5e druk, Deventer: Wolters Kluwer 2021/7075.

71 Rb. Amsterdam 4 December 2013, ECLI:NL:RBAMS:2013:8883, *RI* 2014/46, *JOR* 2014/340.

72 Dutch Bankruptcy Act, Article 241(a)(2).

The regulation of a stay in the bankruptcy procedure is similar to that applicable in the suspension of payments. Dutch law provides for a stay of enforcement actions brought by individual creditors upon the commencement of a bankruptcy case.[73] Consequently, individual enforcement actions come to an end as soon as a bankruptcy order is pronounced. The basic rule is that creditors can only assert their claims by submitting them for verification, and that these claims cannot be enforced outside bankruptcy.[74] This follows from the "fixation principle" (*fixatiebeginsel*), pursuant to which a legal position of all parties involved becomes "fixed" or "immutable" as a result of bankruptcy. The fixation principle offers creditors protection against the reduction in the assets of the estate available for distribution in bankruptcy and against an increase in liabilities of the debtor, which could result in reduced bankruptcy payouts.[75] However, as in the case of the suspension of payments, a bankruptcy stay does not apply to secured creditors, who can enforce security rights and sell the pledged or mortgaged asset as if there were no bankruptcy.[76] This "separatist" position of secured creditors dates back to the onset of the Dutch Bankruptcy Act of 1893 (in force since 1896) and is intended to promote lending.[77]

As in the suspension of payment, in a bankruptcy, a cooling-off period might be imposed by a supervisory judge, either at the request of an interested party or *ex officio*.[78] The aim of this cooling-off period is to enable an IP to investigate which assets belong to the estate and which assets should be preserved for the estate, for example, with a view to the continuation of the debtor and/or a going concern sale of its business.[79] The maximum duration of a cooling-off period is four months, consisting of an initial two

73 Dutch Bankruptcy Act, Article 33.

74 Dutch Bankruptcy Act, Articles 26 and 110.

75 HR 28 January 2022, ECLI:NL:HR:2022:80, r.o. 3.2.1, *NJ* 2022/50; HR 18 December 1987, *NJ* 1988/340, m.nt. G (*OAR/ABN*).

76 Dutch Bankruptcy Act, Article 57. F.M.J. Verstijlen, F.M. van Nieuwstadt, Stelling: De separatistenpositie voor zekerheidsgerechtigden moet worden afgeschaft, TvI 2005/14; G.D. Hoekstra, De positie van de pandhouder in het faillissementsrecht (diss. Groningen), Den Haag: Boom Juridische Uitgevers 2007, p. 132-135.

77 E.F. Verheul, GS Faillissementswet, commentaar op art. 57 Fw. For criticism of creditor separatism, see S.C.J.J. Kortmann, Het faillissement, een paradijs voor banken (afscheidsrede Nijmegen), Nijmegen: Radboud Universiteit 2017.

78 Dutch Bankruptcy Act, Article 63(a). If the applicant, whether a debtor or a creditor, requests a cooling-off period at the moment of the bankruptcy filing, the cooling-off period is ordered by the court. See M.J. van der Aa, De afkoelingsperiode in faillissement (diss. RUG), Kluwer 2007; B. Wessels, Gevolgen van faillietverklaring (1) Wessels Insolventierecht nr. II, 5e druk, Deventer: Wolters Kluwer, 2019/2596ff.

79 Parl. Gesch. Wijziging Rv. e.a.w., Inv. 3, 5 en 6, p. 414; S.C.J.J. Kortmann, N.E.D. Faber (red.), Geschiedenis van de Faillissementswet. Wetswijzigingen, Zwolle: W.E.J. Tjeenk Willink 1995, p. 203-204.

months plus a possible extension of up to two months, which includes the cooling-off granted in the suspension of payments.[80]

Lastly, a cooling-off period can also accompany negotiations of a WHOA scheme. The Dutch Bankruptcy Act stipulates that a debtor or the restructuring expert, if appointed, may request the court to order a cooling-off period if the debtor has submitted a declaration regarding the preparation of a WHOA plan and has proposed a plan or undertakes to propose such a plan within two months.[81] Hence, in a WHOA procedure, there is no automatic stay. Yet if a cooling-off period is granted by the court, during such a period (maximum four months with a possibility of extension up to eight months in total): (i) third parties cannot enforce their rights against the debtor's assets without leave from the court; (ii) the court can lift attachments at the request of the debtor; and (iii) the review of requests to open bankruptcy or suspension of payments proceedings is suspended.[82] When the court has announced a general cooling-off period, the suspension of individual enforcement rights in principle applies to all creditors. However, if the cooling-off order is addressed to a specific group of creditors (which is possible under the Dutch Bankruptcy Act), only those creditors cannot take recourse against the debtor's assets.

The cooling-off period can be ordered if there is *prima facie* evidence that it is necessary for the debtor to continue its business during the preparation and negotiation of a WHOA plan. Moreover, at the time when the cooling-off period is announced, it should be reasonable to assume that the interests of the debtor's joint creditors are served by this measure and that it would not materially prejudice the interests of third parties.[83] The cooling-off period is in the interest of creditors if the preserved going concern value and potential payouts exceed the liquidation value. As for material prejudice, insofar as collateral is established on the debtor's property, no such prejudice exists if the collateral value remains stable during the cooling-off period.[84] When considering the imposition of a cooling-off period, courts conduct a balancing exercise, taking into account potential payouts that could be expected without the cooling-off period (i.e. in bankruptcy), the viability

80 Rb. Amsterdam 4 December 2013, *JOR* 2014/340, ruling that a cooling-off period in the suspension of payments is deducted from the term of a cooling-off period in the subsequent bankruptcy.

81 Dutch Bankruptcy Act, Article 376(1). Rb. Overijssel 16 July 2021, ECLI:NL:RBOVE:2021:2907, r.o. 3.6, *RI* 2021/82.

82 Dutch Bankruptcy Act, Article 376(2).

83 Dutch Bankruptcy Act, Article 376(4). Rb. Den Haag 15 January 2021, ECLI:NL:RBDHA:2021:198, r.o. 4.6ff, *RI* 2021/25, *JOR* 2021/77.

84 Rb. Oost-Brabant, 25 February 2022, ECLI:NL:RBOBR:2022:916, r.o. 4.9-4.11.

of the debtor, and the likelihood of successfully adopting a WHOA plan.[85] Available evidence shows that courts are likely to grant cooling-off requests (>80% approval rate), whether to support the continuity of the debtor's business during restructuring or to facilitate an orderly liquidation of a non-viable company.[86] If the statutory requirements for a cooling-off period are no longer satisfied, the court must lift the stay, either at the request of the debtor, a third party, or on its own initiative.[87]

11.2.4 Summary of national law approaches

This section highlights the diversity of rules regarding a stay across different jurisdictions. This relates to:

- *Availability of a stay*, protecting the debtor against creditors' claims. For example, a stay is a feature of English administration and liquidation proceedings, Dutch bankruptcy and suspension of payments, and US bankruptcy proceedings. At the same time, certain procedures available to financially distressed debtors (e.g. English schemes of arrangement, CVAs and restructuring plans) do not come with a statutory stay.
- *Operation of a stay*. A stay may be automatic and connected to the opening of a proceeding. This is the case in US Chapter 11, English administration and Dutch bankruptcy and suspension of payments proceedings. By contrast, the Dutch cooling-off period available in a WHOA scheme can only be granted upon the filing by the debtor or a restructuring expert, if appointed. In the UK, procedures which do not trigger a stay (as mentioned above) could be supplemented by a stand-alone moratorium.
- *Duration of a stay*. Another aspect characterising the operation of a stay relates to its length. While in some cases, the duration of a stay coincides with the duration of the procedure (e.g. English administration, US Chapter 11, Dutch bankruptcy), in other instances, the maximum length of a stay is prescribed by law (e.g. English moratorium, cooling-off periods in a WHOA scheme, bankruptcy and suspension of payments procedures of the Dutch Bankruptcy Act).
- *Scope of a stay*. The scope addresses the types of creditors and/or contracts that fall under a stay. A category of creditors who often enjoy priority and

85 Rb. Rotterdam 8 March 2021, *JOR* 2021/247, m.nt. Mennens; Rb. Oost-Brabant, 17 September 2021, r.o. 3.7., *RI* 2022/6, noting that the necessity of a cooling-off period is substantiated by the fact that the WHOA plan, if successfully implemented, would lead to a better result for creditors than the alternative of bankruptcy.

86 R.D. Vriesendorp et al., One year and 100 court decisions later: Dutch restructuring scheme in practice, 23 March 2022. The bill implementing the Restructuring Directive in the Netherlands explicitly authorizes granting a stay to support an orderly winding-up of the debtor company.

87 Dutch Bankruptcy Act, Article 376(10).

may be carved out from a stay are secured creditors. For example, an English liquidation stay and a stay triggered by Dutch bankruptcy and suspension of payments filings do not affect secured creditors. These creditors can proceed with enforcing their security rights. Conversely, a US bankruptcy stay, English administration stay, and Dutch cooling-off period cover or may cover enforcement rights of secured creditors. In addition to creditors protected by *in rem* security rights, exemptions from a stay could apply to parties in financial contracts. For example, the new UK moratorium procedure does not affect contracts "involving financial services", including a loan agreement, while the automatic Chapter 11 stay does not affect contractual rights of counterparties to financial contracts (e.g. swap and repurchase agreements).

This diversity of regulatory frameworks concerning a stay can be explained by the differences in the applicable procedures and their intended purposes (e.g. liquidation-oriented v. rescue oriented, pre-insolvency v. insolvency, court-supervised v. out-of-court procedures). However, these important factors alone cannot fully explain the variations in the design and qualities of a stay across jurisdictions. In this regard, Wessels and Madaus convincingly argue that "a 'stay' serves as a tool to balance, on the one hand, the interests involved with restructuring a viable business, and, on the other hand, the interests of certainty, predictability and stability of contractual positions."[88] This balancing exercise naturally results in different solutions, influenced by the normative commitment to freedom of contract (traditionally strong in the UK) and the organisational and institutional environment in which legal rules are developed and applied. Paterson notes that in the UK, until the early 2000s, large corporate reorganisations operated outside the court system, and since the 2000s, most reorganisations have been confined to financial liabilities.[89] In contrast, the US Bankruptcy Code was adopted with a range of tools to effectuate full operational and financial restructurings, as they were prevailing at that time. Whether these tools, including an automatic stay – the US bankruptcy law's core institution, preserve their importance in view of the changing corporate structures and a move towards the service economy is questioned by some scholars.[90]

88 B. Wessels and S. Madaus, Rescue of Business in Europe: A European Law Institute Instrument, OUP, 2020, p. 195.

89 S. Paterson, Corporate Reorganization Law and Forces of Change, OUP, 2020, p. 2.

90 M.J. Roe, Three Ages of Bankruptcy, Harvard Law Review, Vol. 7, 2017, pp. 187-219; J. Armour, A. Hsu, A. Walters, The Costs and Benefits of Secured Creditor Control in Bankruptcy: Evidence from the UK, Review of Law & Economics, Vol. 8, 2012, pp. 101-135, noting that the UK market practice of all-encompassing security interest with a single bank gave it effective control over the debtor's assets, and that English law effectively allowed a private liquidation via administrative receivership, making a stay unnecessary. This contrasted significantly with the US bankruptcy law, which is underpinned by the idea of a bargain between the debtor's creditors, supported by a wide-ranging stay.

In terms of operation, an automatic stay maximises legal certainty, yet it may be less justified from the perspective of proportionality when compared to a tailored and court-ordered stay.[91] After all, a stay on creditor actions hinders creditors' enforcement rights.[92] This is why the duration of a stay could be limited, and its extension might be based on the showing that it continues to serve its purpose.[93] Regarding the scope, a far-reaching stay binding secured creditors facilitates equal treatment of creditors. It may also contribute to the preservation of the debtor's estate value and the development of a restructuring plan. However, the need to ensure adequate protection of the property rights of secured creditors and the value of security justifies lifting a stay in certain circumstances.[94] Given the main focus of this book, the following paragraphs address the group insolvency context.

11.3 Extension of an Enforcement Stay to Group Entities

11.3.1 A stay and group insolvency

One of the key features of recent restructuring reforms is that they provide for the possibility to stay individual enforcement actions, giving the debtor a breathing space, protecting its going concern value, and improving its position in negotiations with creditors. However, the success of restructuring or insolvency proceedings often depends on the preservation of financial and operational links within the group of companies (section 4.4.1.). The threat of enforcement against the debtor's affiliates (co-debtors, guarantors, collateral providers) may significantly weaken the debtor's bargaining power. One way to secure a stay for group companies is to initiate separate proceedings with respect to each of them. Arguably, this could drive up transaction costs and substantially complicate coordinated group

91 R. Bork, Rescuing Companies in England and Germany, OUP, 2012, paras. 10.04-10.07.

92 L. Stanghellini et al. (eds), Best Practices in European Restructuring: Contractualised Distress Resolution in the Shadow of the Law, Wolters Kluwer, 2018, p. 117, observing that "a stay directly impinges on creditors' legal and contractual rights, limiting them" and arguing that "the longer the stay, the higher the confidence should be in the fact that the stay is maximising value for the creditors."

93 See e.g. Article 376(5) Fw. See Rb. Den Haag 3 September 2021, r.o. 4.4., *RI* 2021/91 (*ADO Den Haag*), extending the cooling-off period for a Dutch association football club and referring to the progress made in reaching a plan (extensive consultation with stakeholders, completed class formation, establishment of a data room with important documents, etc.).

94 Restructuring Directive, Article 6(9)(c); Article 376(10) Fw; 11 U.S. Code § 362(d). On lifting of the administration stay, see *Bristol Airport Plc v. Powdrill* [1990] Ch 744; *Re Atlantic Computer Systems plc (No 1)* [1992] Ch 505; *Mackay v. Kaupthing Singer* [2013] EWHC 2533 (Ch). In the UK, the underlying principle is that an administration for the benefit of unsecured creditors should not be conducted at the expense of those who have proprietary rights which they are seeking to exercise, save to the extent that this may be unavoidable and even then, this will usually be acceptable only to a very limited extent.

restructuring. The question is whether, in order to preserve the overall value of the group enterprise, a stay can (and should) be extended to the debtor's group members and, if the answer is positive, under what conditions.

In essence, the rationale behind an intra-group stay extension overlaps with that of a third-party release discussed in the previous chapter. Both tools aim to preserve enterprise value, ensure a coordinated response to financial distress, and give the debtor additional leverage in negotiations with creditors. However, there is a distinction between them. While a third-party release entails group debt deleveraging or debt adjustment, the extension of a stay does not affect the existence and extent of the liability of third parties. It only gives these third parties a temporary break or interim protection to allow the adoption of a group solution, whatever this may be (e.g. group business sale as a going concern, restructuring of group members' obligations). In this sense, the extension of a stay is less intrusive compared to a third-party release. The extended stay can be used on its own or combined with a third-party release. Without a stay, the release may be less efficient since, until the confirmation of a plan with a third-party release, a guaranteed creditor can enforce its claim against the guarantor.

UNCITRAL considers the extension of a stay to the debtor's affiliates to be beneficial, especially in cases where there is "interrelatedness of the business of the group".[95] This is likely to be the case in a situation when financing is arranged on a group basis. The Restructuring Directive does not clearly authorise such an extension.[96] Yet it acknowledges that if provided for under national law, it should be possible for a stay to apply for the benefit of third parties, including guarantors and collateral givers.[97] Ultimately, the Directive does not offer much guidance on the nature of third parties (e.g. whether they should be group entities or not) or the conditions under which a stay can be extended to shield third parties.

Under English law, there is no express statutory authority to extend the benefits of a stay to third parties. As a result, a group guarantor seeking to benefit from a stay will need to initiate its own procedure, such as administration or moratorium.[98] The statutory language does not support the extension of a stay to non-debtors. For example, the Insolvency Act 1986 specifies

95 UNCITRAL Legislative Guide, Part three, 2010, Ch. II, para. 40.

96 Restructuring Directive, Articles 6 and 7.

97 Restructuring Directive, Recital 32.

98 The UK is not the only jurisdiction that adheres to this approach. In *State Bank of India vs. V. Ramakrishnan and Ors.* (14.08.2018 - SC), the Supreme Court of India, interpreting section 14 of the Insolvency and Bankruptcy Code 2016, clarified that the insolvency moratorium could not be extended to the debtor's personal guarantor.

that the administration stay applies to a company in administration,[99] and the liquidation stay applies to a company against which a winding-up order has been made.[100] Similarly, in the case of a stand-alone moratorium, the law stipulates that it is available to an eligible company upon filing or lodging documents at the court.[101] Hence, the availability of a stay is linked to the opening or filing for the opening of an insolvency procedure by a specific entity. Since the UK does not seem to offer the possibility to extent a stay to third parties, the next paragraphs will examine jurisdictions that either allow extended stays through case law (the USA) or directly approve them in the statute (the Netherlands).

11.3.2 The USA: limited possibility of a stay extension

As a general rule, the automatic stay does not extend to third parties.[102] This position is based on the language of the US 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"[103] (emphasis added). Thus, by its terms, the US Bankruptcy Code's stay applies only to debtors, property of the debtor, or property of the estate, and does not cover proceedings against non-debtor parties, such as group guarantors or co-debtors.

Nevertheless, the power of a court to enjoin actions against third parties has been recognised in exceptional circumstances where these 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."[104] The extension of a stay has also been allowed when a claim against a third party is considered to have "an immediate adverse economic consequence for the debtor's estate"[105] and when protection by a stay is believed to be "essential to the debtor's

99 Insolvency Act 1986, Schedule B1, para. 43.

100 Insolvency Act 1986, sec. 130(2).

101 Insolvency Act 1986, Part A1.

102 *Credit Alliance Corp. v. Williams*, 851 F.2d 119, 121 (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).

103 11 U.S. Code § 362(a)(6).

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

105 *Ritchie Capital Management, L.L.C. v. Jeffries*, 653 F.3d 755, 763 (8th Cir. 2011), citing *Queenie, Ltd. v. Nygard Int'l*, 321 F.3d 282, 287-88 (2d Cir.2003).

efforts of reorganization."[106] For example, 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.[107] 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, the extension of a stay furthered public interest in a successful reorganisation since "reorganizations preserve value for creditors and ultimately the public."[108]

Two observations can be made regarding the approach of US courts to the extension of a bankruptcy stay to group affiliates.

First, the legal basis for extending a stay to non-debtor parties is not clear. Some courts base their decisions on §105(a) of the US Bankruptcy Code and the equitable power to grant an injunction to enjoin third-party litigation.[109] According to §105(a), the "court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title."[110] However, it is pointed out that §105(a) does not constitute an independent source of subject matter jurisdiction or a repository of substantive rights. Instead, it allows the court to issue an order when "necessary or appropriate" to carry out the provisions of the Bankruptcy Code, for example, §362(a).[111] Other courts rely exclusively on §362(a) when extending the stay, even though this section does not explicitly provide for such an extension.[112] Thus, there is no certainty whether the extension is based on §105(a) alone, or in conjunction with §362(a), or solely on §362(a).

---

106 *In re Union Trust Philadelphia, LLC*, 460 B.R. 644, 658 (E.D. Pa. 2011); *In re Hart*, 530 B.R. 293, 308 (Bankr. E.D. Pa. 2015); *In re Saxby's Coffee Worldwide, LLC*, 440 B.R. 369, 386 (Bankr. E.D. Pa. 2009).

107 *In re Caesars Entertainment Operating Co., Inc.*, 561 B.R. 441 (Bankr. N.D. Ill. 2016).

108 Ibid., at 453. *In re Integrated Health Services, Inc.*, 281 B.R. 231, 239 (Bankr. D.Del. 2002), confirming that "[p]romoting a successful reorganization is one of the most important public interests."

109 *In re Calpine Corp.*, 365 B.R. 401, 409 (S.D.N.Y. 2007). In this case, the court first noted that the request by the debtor for an injunction under the US Bankruptcy Code, authorising the court to issue any order, is treated as a request for a preliminary injunction. It stated that the following factors should be evaluated: (1) whether there is a likelihood of successful reorganisation; (2) whether there is imminent irreparable harm to the estate in the absence of an injunction (whether there is imminent, substantial and irreparable threat to the reorganisation process); (3) whether the balance of harms tips in favour of the moving party; and (4) whether the public interest weighs in favour of an injunction.

110 11 U.S. Code § 105(a).

111 *In re Bora Bora, Inc.*, 424 B.R. 17, 23 (Bankr. D.P.R. 2010); *In re Continental Airlines*, 203 F.3d 203, 211 (3d Cir. 2000), observing that section 105(a) does not "create substantive rights that would otherwise be unavailable under the Bankruptcy Code."

112 See e.g. *In re QA3 Fin. Corp.*, 2011 WL 2678591 (Bankr. D.Neb. 2011).

Second, it has been observed that the case law on the extension of a bankruptcy stay is rather "confusing" when it comes to the appropriate standard or test.[113] What is clear is that the possibility to enjoin litigation against third parties is limited and depends on the facts of each case. Normally, the party seeking the extension should meet the test applicable in injunction actions, including, among other things, a reasonable likelihood of successful reorganisation and the possibility that the debtor would suffer some cognizable prejudice or irreparable injury as a result of the creditor's lawsuit against the third party. The latter can be demonstrated if the third party has a right of indemnity against the debtor.[114] While the general approach remains restrictive, US courts have been willing to extend a stay or grant an injunction to enjoin actions against the debtor's affiliates where it was necessary for the successful restructuring. This is particularly the case when there is a strong showing that the debtor's reorganisation would be severely hampered if the lawsuit against a non-debtor group entity were to proceed. Courts retain broad discretion in determining whether a bankruptcy stay can be extended. The need for a group-wide extension is somewhat reduced due to the prevailing practice of simultaneous bankruptcy filings by all or the majority of entities comprising the group.[115] As a consequence, each group entity secures a separate automatic stay.

While the extension of an enforcement stay in the USA is not group-specific – it can benefit debtors' directors, insurers, and even third parties who allegedly participated in a Ponzi scheme[116] – the Netherlands has implemented reforms that aim to create efficient tools to address financial distress within

---

113 S. Maza, Enjoying Third Party Litigation under §362, Norton Journal of Bankruptcy Law & Practice, Vol. 26, 2017 (online version).

114 *First Nat'l Bank v. Kanawha Trace Dev. Partners*, 87 B.R. 892 (Bankr. E.D.Va. 1988); *In re Lomas Fin. Corp.*, 117 B.R. 64 (S.D.N.Y. 1990); *Rivera-Olivera v. Antares Oil Services*, 482 B.R. 44 (D.P.R. 2012), extending a stay to third parties and noting that the process established by the bankruptcy court allows third parties to submit proofs of claim for indemnification or contribution against the debtors, and because certain third parties in this case have submitted or will submit such claims against the debtors, a judgment against non-debtor third parties may constitute a judgment against the debtors, which, in turn, could negatively impact the liquidation process.

115 This practice is facilitated by the "affiliate-filing rule" of 28 U.S. Code § 1408. This rule allows a company to file a bankruptcy petition in a district where its affiliate is the debtor in a pending title 11 case. Under Rule 1015(b) of the Federal Rules of Bankruptcy Procedure, if a joint petition or two or more petitions are pending in the same court by or against a debtor and an affiliate, the court may order a joint administration of the estates. These rules promote the reorganisation of an entire business enterprise in a centralised manner. Another reason for group-wide filings may be the general unavailability of such a remedy as a third-party release in the USA (see section 10.2.3.).

116 *In re Madoff*, 848 F.Supp.2d 469 (S.D.N.Y. 2012), granting a §105(a) injunction and barring the bankrupt investment firm's customers from bringing class action lawsuits against third parties with whom the trustee was on the brink of settling pending fraudulent transfer action lawsuits.

enterprise groups. Among other legal tools inspired by US Chapter 11 and English schemes of arrangement, Dutch bankruptcy law permits the extension of a cooling-off period to group affiliates as part of a WHOA scheme.[117]

11.3.3 The Netherlands: extension of a stay to group entities

The previous chapter showed that Dutch law responds to the group environment and permits a WHOA plan to modify creditors' rights against legal entities that form one enterprise group with the debtor – a third-party release.[118] The rights of creditors towards debtor's affiliates must intend to satisfy or to secure the performance of the debtor's obligations (e.g. cross-guarantees, provision of collateral) or the obligations for which such legal entities are liable with the debtor (e.g. co-debtorship). Among other requirements, the law states that a group entity subject to a release must be in a situation where it may reasonably be assumed that it will be unable to continue paying its debts. Hence, there has to be a threat of insolvency that justifies a court's intervention. Other requirements include the consent of the to-be-released group entity, the court's jurisdiction over it, and compliance with substantive requirements, including the best-interest-of-creditors test.[119]

If a WHOA plan seeks to amend creditor's rights against a non-debtor group entity, the debtor can request the court to extend a cooling-off period to that group entity.[120] This extension is premised on the proposed amendment of creditors' rights against that group entity through the plan. This is why, to be eligible for an extended stay, the relevant group entity must meet the conditions set for a third-party release, such as being in a state of financial distress.

Without extending a cooling-off period to group guarantors, in some cases, it may be too late to implement a third-party release. By the time of plan confirmation, the assets of such group guarantors might have been dismembered, and their business could be destroyed. In a recent case involving a group engaged in international e-commerce business, the court approved the extension of a cooling-off period to the debtors' corporate shareholders.

---

117 Legal systems that include rules for the extension of an enforcement stay in a group scenario are Germany and Singapore. In Germany, StaRUG, §49(3) permits the extension of a stay of actions arising from intra-group liability arrangements to protect group guarantors and collateral providers. Similarly, in Singapore, according to IRDA section 65(1), 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 the commencement or continuation of any proceedings or enforcement actions, including enforcement of security rights, against a related company.

118 Dutch Bankruptcy Act, Article 372(1).

119 Dutch Bankruptcy Act, Article 384(3).

120 Dutch Bankruptcy Act, Article 372(3), together with Article 376(1).

The court observed that: (i) the debtors – sister companies, and their shareholders were organisationally and financially interconnected and formed an economic unit within the meaning of Article 2:24b BW (see section 2.3.); (ii) the shareholders were jointly and severally liable for the debts owed to financiers by the debtors; (iii) the successful restructuring required an amendment of creditors' rights against the guarantors-shareholders, pursuant to the proposed third-party releases.[121] The court linked the necessity to extend the cooling-off period with the operational and financial interdependence of group entities and the proposed restructuring through third-party releases.

The extension of a cooling-off period to the debtor's affiliates shall not materially prejudice the interests of a guaranteed creditor. This requirement can be inferred from the general provisions applicable to a cooling-off period.[122] If during the extended cooling-off period the financial position of a group guarantor significantly deteriorates, or if such entity is involved in value-destroying activities, it should be possible to lift the extended stay. The same rule applies if the value of third-party collateral diminishes during the cooling-off period. This rule is necessary for maintaining a balance between the interests of all parties involved and bears resemblance to the adequate protection requirement of the US Bankruptcy Code.

11.4 Conclusions and Suggestions

11.4.1 Overview of main findings

A stay on individual enforcement actions is a defining feature in most insolvency law regimes. It serves to preserve the value of the insolvency estate, facilitates its efficient administration, and promotes the restructuring of viable enterprises. In this chapter, we have demonstrated that laws differ when it comes to the availability, operation (automatic vs. non-automatic), duration (limited in time vs. applying throughout the entire procedure), and scope (general vs. targeted) of a stay.

Among the laws studied in this book, the automatic stay provided by the US Bankruptcy Code stands out as the most powerful, with an extremely broad scope. In contrast, Dutch bankruptcy and suspension of payments

121 Rb. Oost-Brabant 25 February 2022, ECLI:NL:RBOBR:2022:916, r.o. 4.13; Rb. Amsterdam 15 February 2021, ECLI:NL:RBAMS:2021:6516, granting the request to order a cooling-off period and extend it to the debtor's affiliates and observing that: (i) a temporary stay is necessary for the continuation of the debtor's business; (ii) the plan offers higher payouts to the creditors compared to bankruptcy; and (iii) the bankruptcy is unavoidable without a cooling-off period and the plan.

122 Dutch Bankruptcy Act, Article 376(4)(b).

procedures do not affect secured creditors unless the court orders a temporary cooling-off period. Without it, secured creditors can enforce their security rights as if there were no bankruptcy. UK law offers a patchwork of different rules and procedures that can be used either on a stand-alone basis or in combination with other procedures. Another area where national laws diverge is whether a stay can be extended to third parties, including debtor's group members, who are not themselves subject to the relevant insolvency or restructuring procedure but are linked to the debtor through various cross-liability arrangements (e.g. intra-group guarantees). The review of national legal systems reveals a variety of attitudes and criteria for extending a stay to benefit debtor's affiliates, which are summarised below.

Figure 13. Extension of a stay to third parties

	USA	**Netherlands**
Is the extension of a stay to third parties available?	Only available in exceptional circumstances	Explicitly available in WHOA schemes
Who can request the extension of a stay?	Debtor or a third party	Debtor or restructuring expert, if appointed
Who can benefit from the extension of a stay?	Broad category of persons (e.g. group entities, officers, insurance companies)	Group entities that have secured the obligation of the debtor (guarantor, collateral provider) or are liable with the debtor (co-debtors)
What are the requirements for the extension of a stay?	Different considerations, inter alia, (i) identity between the debtor and a third party; (ii) a claim against a third party has an immediate adverse effect on the debtor's estate; (iii) a stay is essential to debtor's reorganisation efforts	(i) A WHOA plan entails the amendment of creditors' rights against the related (group) company, (ii) this group company is in financial distress, (iii) it gives its consent, and (iv) the court has jurisdiction over it. The extension of a cooling-off period must not materially prejudice the creditor's interests

We argue that given the group economic reality, extending a protective shield of an insolvency stay to debtor's affiliates may contribute to achieving efficient restructuring of a group enterprise. It can help preserve group synergies, maintain operational continuity of group members, and strengthen the debtor's bargaining power. While English law does not seem to permit such an extension, US and Dutch laws are more flexible and, to one extent or another, allow courts to enjoin actions against third parties.

In the US, bankruptcy courts tend to enjoin actions against non-debtor parties in rare and exceptional circumstances. The exact configuration of these circumstances remains somewhat ambiguous, dependent on specific facts,

and may vary from one court district to another. Moreover, the legal basis for the extension of a stay is disputable. However, courts often grant injunctions that benefit group companies if it is deemed essential for the debtor's reorganisation or if failing to do so could result in immediate adverse economic consequences for the debtor's estate.

Finally, Dutch law clearly permits the extension of a stay (a cooling-off period to be more precise) to debtor's affiliates within the WHOA framework. It places a cooling-off period in the context of a WHOA restructuring plan, which aims to amend creditors' rights against related group members (i.e. third-party release) and targets debtor's guarantors, collateral providers or co-debtors. Hence, Dutch law makes the extension of a stay conditional on a particular type of contractual relationship, the amendment of creditors' rights against a third party in a WHOA scheme, and the financial position of such a third party. Essentially, the extension of a stay plays an ancillary role, supporting the effectiveness of a (future) restructuring plan containing a third-party release.

11.4.2 Suggestions on the extension of a stay to group entities

Based on an overview of national law approaches and in pursuit of a balanced solution, the following suggestions can be made regarding the extension of a stay in the group context.

First, the extension of a stay on individual enforcement actions to non-debtor group entities may be useful as a tool promoting the preservation and maximisation of the estate value, and specifically of the group enterprise value (see section 4.4.1.). However, the extension of a stay should not be automatic. Non-debtor group entities are not themselves subject to insolvency proceedings and, therefore, should not automatically benefit from insolvency law protections, including the insolvency stay. Granting an automatic extension of a stay would go too far in limiting creditors' rights and unduly restrict the protective function of intercompany guarantees and other forms of cross-liability arrangements. Instead, any extension of a stay should be carried out following notice and a court hearing, ensuring that affected creditors have an opportunity to be heard and participate in the decision-making process. This approach aligns with the notion of (procedural) fairness (section 5.2.).

Second, the case for the extension of an enforcement stay to non-debtor group companies is stronger in the following scenarios:

- The first scenario is when an enterprise group is integrated, and the non-debtor group company is or may become financially distressed or insolvent as a result of creditor's enforcement action. In this case, the

extension of a stay to protect another group company can be justified if that company plays an integral and necessary role in the anchor debtor's restructuring or future operations.

- The second scenario is when the debtor's restructuring plan envisages a third-party release. If a creditor of the to-be-released group company (e.g. group guarantor, co-debtor or collateral provider) is allowed to pursue its claim against this company and collect on its claim before a release is confirmed and takes effect, the third-party release could become futile. Paraphrasing the well-known legal maxim "Justice delayed is justice denied", we can say, "An extension of a stay delayed is a third-party release denied."

By contrast, the extension of an enforcement stay appears to be less justified where:

- The creditor's action against a non-debtor group company is unlikely to jeopardise or frustrate a restructuring attempt of the anchor debtor, and such action does not disrupt the debtor's business during negotiations with creditors. This may be the case where the group is not integrated (i.e. decentralised groups), and the businesses of the debtor and its group affiliates are not aligned, dependent, or synergetic (section 2.4). In such instances, the extension of a stay is simply not necessary. The necessity requirement is an integral part of the proportionality analysis (see section 5.4.3.). If the extension of a stay is not necessary for successful restructuring of the debtor, it is hardly proportional. However, if the debtor's affiliate needs insolvency law protection, it can secure it by filing its own insolvency petition.
- A debtor's group affiliate is solvent and liquid, and the creditor's action does not undermine its solvency or liquidity. In a case like this, there is unlikely to be a reason for financial relief and insolvency protection. In general, limiting contractual rights exercised against solvent entities is more likely to be disproportionate. However, in rare circumstances, a stay covering a solvent group guarantor, co-debtor or collateral provider could be proportionate, particularly when it aims to protect an asset or assets (e.g. production equipment) central to the business of the entire group or the anchor debtor.[123] Nevertheless, any extension of an insolvency stay to solvent companies should be subject to strict scrutiny by the court.

Third, the extension of a stay should in principle be available to achieve the goal of business preservation, regardless of whether the business remains

123 UNCITRAL Legislative Guide, Part three, 2010, Ch. II, para. 41. However, UNICTRAL recognises that ordering insolvency-related relief with respect to a solvent group member may conflict with the protection of property rights and raise constitutional law questions. See ibid., para. 42.

within current legal entities or is sold and transferred to new entities. This means that the extension of an enforcement stay should be used to preserve and ensure the continuation of economically viable businesses whose going concern value exceeds their liquidation value. If the debtor's assets are to be liquidated on a piecemeal basis, the extension of a stay may be unnecessary or ill-suited to facilitate the preservation of value.

However, there are instances where the non-viability of an anchor debtor, a third party (e.g. group guarantor), or the entire group enterprise should not preclude the extension of a stay. Such an extension may be needed to facilitate an orderly liquidation of a non-viable business, as exemplified in the Nortel Networks case (section 1.1.2.). In that case, a unified approach to the sale of the group's assets resulted in USD 7.3 billion – an amount that could not have been attained if the assets were sold on an entity-by-entity basis.[124] In cases like this, the extension of a stay makes it possible to preserve the pool of assets spread across different group entities. Consequently, these assets can be bundled and sold together to secure the highest purchase price possible. One might simply need a group-wide stay, even if on a temporary basis, to preserve the global pool of assets which are more valuable if sold together.

Thus, there are situations in which the extended stay is value-maintaining or value-increasing, even if the underlying business is not viable and the debtors are to be liquidated with their assets sold to the highest bidder on the market. Notably, this approach differs from the one adopted in the chapter on third-party releases (section 10.3.2.), where we pointed out that such releases should be reserved for cases seeking going concern value preservation and not asset liquidation.

Fourth, and finally, a restraint on enforcement actions against third parties should not unfairly prejudice the rights of an affected creditor (e.g. guaranteed creditor, creditor benefiting from a third party collateral) or cause substantial detriment to it. This detriment may occur if the value of collateral, held by the debtor's affiliate, significantly depreciates during a stay or if the guaranteed creditor's claim is made worse-off, potentially leading to uncompensated loss. This can happen in a situation where the debtor or a group guarantor 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 cases like this, it should be possible to terminate the extension of a stay. This suggestion is inspired by the approach adopted in the

124 J.L. Westbrook, Corporate Formalism in a Global Economy, in J.P. Sarra and B. Romaine (eds), Annual Review of Insolvency Law, Toronto: Carswell, 2015, observing that the sale of Nortel's assets "realized far more than the parties had expected, no doubt because of the global nature of the sale."

Netherlands for lifting a cooling-off period if the interests of a creditor are materially prejudiced (section 11.3.3.), and the US bankruptcy rule for lifting an automatic stay "for cause, including the lack of adequate protection" (section 11.2.2.). The option to lift an extended stay for valid reasons ensures proportionality in the application of the discussed legal tool. It helps strike a balance between the principles of estate value preservation and the protection of trust and legitimate expectations.

12 Intra-group Rescue Financing: Safe Harbours and Pre-emptive Strategies[■]

12.1 Introduction

This chapter should be seen as a response to the concerns raised in Chapter 7 (on the subordination of intra-group claims) and Chapter 8 (on the avoidance of transactions involving group entities). These preceding chapters have shed light on various issues associated with intra-group financing, with two specific problems warranting attention. The first one is the problem of underinvestment which occurs when socially desirable, value-creating projects and rescue attempts do not take place (section 7.5.4.). Insolvency law rules that provide for the avoidance of related-party transactions or the subordination of insider claims can potentially discourage efficient intra-group rescue financing, as they amplify risks for an assisting company (e.g. guarantor, lender, collateral provider). As a result, the principle of estate value preservation and maximisation may be compromised. The second problem relates to the lack of legal certainty concerning the avoidance of transactions common in group financing, such as cross-guarantees and the provision of collateral, in a situation where a guarantor or collateral provider themselves encounter financially difficulties and become insolvent (section 8.3.).

The absence of predictability and sufficient clarity regarding the permissibility of intra-group transfers, whether through intra-group loans, provision of guarantees or collateral, or other transactions, in going concern and gone concern scenarios to manage financial distress and maximise value, is troubling. The key question is how to find a balance between discouraging overinvestment, asset shifting, asset dilution, and other forms of opportunistic behaviour, while at the same time avoiding underinvestment and facilitating the efficient allocation of resources among group entities. This chapter addresses this question.

■ This chapter builds upon the following previously published work by the author:
- I. Kokorin, Preemptive Financing Arrangements within Cross-Border Banking Groups: Between Flexibility and Legal Certainty, in L. Böffel and J. Schürger (eds), Digitalisation, Sustainability, and the Banking and Capital Markets Union, Palgrave Macmillan Cham, 2022, pp. 377-395.
- I. Kokorin, Intra-Group Financial Support in a Crisis: Between Rescue and Abuse, Norton Journal of Bankruptcy Law and Practice, Vol. 29, 2020, pp. 378-420.

There are different strategies that may be adopted to find a balance. This chapter focuses on two such strategies: (i) ex ante authorisation of transactions within a regulated and supervised framework, a safe harbour, as an ad hoc response to financial distress (section 12.2.), and (ii) several pre-emptive financial arrangements commonly used among banking groups (section 12.3). Section 12.4. concludes with our suggestions.

Thus, we examine both private and public law responses to the balancing problem and draw conclusions from developments in corporate insolvency and in the area of bank resolution. The figure below places the discussed strategies along a timeline, reflecting the demise curve or a downward spiral of the company's financial situation. Transaction avoidance rules primarily apply to transactions entered into by the debtor before an insolvency filing, but at a time when the debtor is either insolvent, foreseeably insolvent, or otherwise financially distressed.[1] Hence, ex post judicial review of transactions is situated in the middle column. Ex ante authorisation is available post-filing, whether it is carried out in an insolvency or pre-insolvency procedure (e.g. preventive restructuring framework). It is on the right side of the figure. Finally, preemptive arrangements are established long before insolvency, when the debtor is entirely solvent and liquid. Therefore, they are positioned on the left side of the figure.

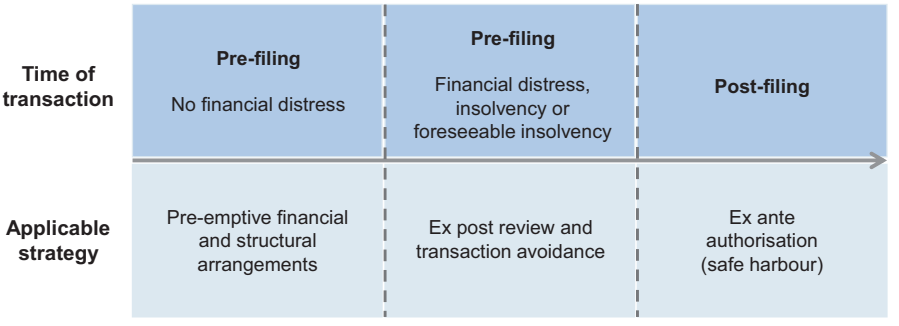

Figure 14. Strategies addressing group financial transactions

1 R. Bork, M. Veder, Harmonisation of Transactions Avoidance Laws, 1st edn, Intersentia, 2022, paras. 3.15 and 4.32, explaining that transaction avoidance law commonly addresses transactions concluded or performed prior to the opening of insolvency (liquidation) proceedings. In most legal systems, upon the opening of such proceedings, the rights of disposal and administration over the debtor's estate are shifted to an IP. Transactions occurring after the commencement of insolvency proceedings typically need to be entered into by an IP, with his approval, or the approval by the court.

12.2 Ex Ante Approval Mechanisms and Safe Harbours

12.2.1 Three types of safe harbours

The past years have witnessed the introduction of safe harbour rules into national laws. Before discussing these rules, it is important to clarify the term "safe harbour", as it is used in different contexts and can refer to different things.

First, a safe harbour regime may involve a carve-out of specific types of legal relationships (e.g. certain types of contracts or payments) from otherwise applicable legislation. For example, the US Bankruptcy Code establishes a safe harbour for certain types of financial transactions by granting them immunity from transaction avoidance[2] and insulating them from the prohibition of ipso facto clauses.[3] Similarly, in the UK, the recently introduced limitations on ipso facto clauses do not apply to most financial agreements (e.g. securities contracts, swap agreements, etc.).[4] These carve-outs are introduced to preserve liquidity, instil confidence in financial markets, and mitigate systemic risk.[5]

Second, a safe harbour could encompass the protection of corporate officers from personal insolvency-related liability. An example of such a safe harbour can be found in Australian law, which lays down an exception to insolvency trading liability for directors.[6] This exception applies when a director, in the vicinity of insolvency, engages in "one or more courses of action that are reasonably likely to lead to a better outcome for the company" and "the debt is incurred, or the disposition is made, directly or indirectly in connection with any such course of action."[7] In this context, "a better outcome" means "an outcome that is better for the company than the immediate

2 11 U.S. Code § 546(e). C.W. Mooney Jr., The Bankruptcy Code's Safe Harbors for Settlement Payments and Securities Contracts: When Is Safe Too Safe? Texas International Law Journal, Vol. 49, 2014, pp. 245-269.

3 11 U.S. Code § 555 (securities contracts), § 556 (commodities and forward contracts), § 559 (repos), § 560 (swap agreements).

4 Insolvency Act 1986, section 233B(10), Schedule 4ZZA.

5 Whether bankruptcy carve-outs for financial contracts actually reduce systemic risk remains debatable. See M.J. Roe, Derivatives and repos in bankruptcy, in B.E. Adler (ed), Research Handbook on Corporate Bankruptcy Law, Edward Elgar Publishing, 2020, p. 103, arguing that the carve-outs for derivatives and repos reduce incentives for market discipline, encourage more short-term financing and therefore unfavourably affect financial stability.

6 Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Act 2017. See also Explanatory Memorandum, General outline and financial impact, Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017 (Cth).

7 Corporations Act 2001, sec. 588GA.

appointment of an administrator, or liquidator, of the company."[8] The safe harbour regime in Australia balances creditor protection, discouragement of misconduct, and encouragement of entrepreneurship and restructuring attempts.[9] While not providing absolute legal certainty and predictability, this safe harbour aims to assist directors and those dealing with them to navigate "the legal minefield which surrounds attempts at business rescue."[10] Importantly, however, the Australian safe harbour does not give protection against transaction avoidance actions.[11]

Third, while the first safe harbour exempts certain contracts from the scope of specific rules and the second grants protection to directors of financially distressed companies, the third safe harbour takes the form of an antecedent approval mechanism, establishing screening and ex ante authorisation of transactions.[12] This safe harbour is of particular interest as it can address some of the problems inherent in ex post judicial review, such as hindsight bias and uncertainty of outcomes. A well-structured and cost-efficient ex ante approval regime can promote the principle of protection of trust and certainty of transactions, mitigate information asymmetries, avert opportunistic behaviour, and contribute to the preservation of value by facilitating the provision of rescue financing. In the ensuing paragraphs, we delve into these safe harbours as established in Dutch and US law.

UK law is excluded from our analysis, because it lacks a tailored regime that facilitates rescue financing. Some priority may be granted to financing attracted by an administrator in the course of administration; such financing qualifies as an administrative expense.[13] In a standalone moratorium, priority for rescue financing can result from the provision of a security interest over the debtor's property.[14] However, neither schemes of arrangement, nor restructuring plans or CVAs are supported by a rescue financing regime. Several proposals were put forward with the aim of encouraging

8 Corporations Act 2001, sec. 588GA(7).

9 S. Steele, I. Ramsay and M. Webster, Insolvency law reform in Australia and Singapore: Directors' liability for insolvent trading and wrongful trading, International Insolvency Review, Vol. 28, 2019, pp. 363-391.

10 J. Harris, A. Hargovan, Potential liability for directors during corporate restructuring: comparative perspectives, in in P.J. Omar and J.L.L. Gant (eds), Research Handbook on Corporate Restructuring, Edward Elgar Publishing, 2021, p. 164.

11 Compare with the safe harbour under § 546(e) US Bankruptcy Code, which applies to financial contracts.

12 For a brief overview of safe harbours in Belgian, French, German, Spanish and Italian law, see B. Wessels and S. Madaus (eds), Rescue of Business in Europe: A European Law Institute Instrument, OUP, 2020, pp. 246-250.

13 Insolvency Act 1986, Schedule 1, para. 3, under which an administrator has the "power to raise or borrow money and grant security therefor over the property of the company."

14 Insolvency Act 1986, section A26, under which the debtor may grant security over its property if the monitor gives his consent, which can only be given if the monitor believes the grant of security will support the rescue of the debtor as a going concern.

lenders to provide rescue financing in the UK.[15] They included granting security to new lenders over property already subject to charges, in priority to existing charge holders.[16] These proposals did not receive a positive response.[17] When it comes to rescue finance in the UK, it is pointed out that a market-based response has naturally emerged. If the business is deemed viable, additional funding is typically extended by existing or new credit providers on a consensual basis.[18]

12.2.2 The Netherlands: safe harbour under the WHOA

The third type of safe harbours has recently been incorporated in Dutch law. To make rescue financing more attractive, the Dutch legislator initially considered setting up a safe harbour that would offer protection against transaction avoidance for security rights created in the period between the proposal of a restructuring plan and voting on it.[19] No distinction was made between new and old financing, and no specific safeguards against abuse were included.[20] In the final version of the WHOA, a legal framework for the protection of rescue financing was substantially refined. According to Article 42a Fw (in the version applicable since 1 January 2023),

> The preceding article [Article 42, dealing with transaction avoidance] may not be invoked to annul a legal act performed after the debtor has submitted a declaration to the clerk of the court as meant in Article 370(3) or after the court has appointed a restructuring expert […] if the court, upon the debtor's request, has granted prior approval of that act. The court shall grant the requested approval if, at the time of approval it can reasonably be assumed that:

15 The Cork Committee recommended that if the administration order is discharged "all creditors should revert to the position as it was when the original application was made, subject to the rights of priority of payment to anyone who in the meantime has given money or advanced credit to the administrator, to enable the company's business to be carried on as a going concern." Insolvency Law and Practice: Report of the Review Committee, 1982, para. 514.

16 Insolvency Service, Encouraging Company Rescue – A consultation (London: DTI, June 2009). The Insolvency Service, A Review of the Corporate Insolvency Framework: A Consultation on Options for Reform, May 2016, para. 10.21.

17 Insolvency and Corporate Governance, Government Response, 26 August 2018, pp. 75-77.

18 Ibid. See J. Payne, J. Sarra, Tripping the Light Fantastic: A Comparative Analysis of the European Commission's Proposals for New and Interim Financing of Insolvent Businesses, International Insolvency Review, Vol. 27, 2018, p. 184.

19 Continuity of Enterprises Act II (*Wet Continuïteit Ondernemingen II*), 2014, Article 42a. See F.M.J. Verstijlen, Ondersteunende voorzieningen in de WHOA, TvI 2020/4.

20 F.M.J. Verstijlen, Flankerende voorzieningen in de Wet Homologatie onderhands akkoord ter voorkoming van faillissement, in Preadviezen van de Vereniging Handelsrecht, Uitgeverij Paris, 2017, p. 137, noting the desirability of a more cautious and fine-tuned approach.

a. the performance of a legal act is necessary to:
   1. allow the debtor to continue its business during the preparation of a plan […], or
   2. allow the debtor to prepare the plan […], to put it to the vote, or to have it approved by the court in accordance with Article 384.
b. this legal act would be in the interests of general body of creditors and would not materially prejudice the interests of any individual creditors.

The Explanatory Memorandum to the WHOA clarifies that this article deals with a situation in which an attempt is made to adopt a restructuring plan, and financing is provided in that regard. Such financing should be necessary to sustain the debtor's business during the plan's preparation. Article 42a Fw allows the debtor to petition the court for authorisation to perform a certain act, such as granting a security right necessary to obtain new financing. The debtor can attract new financing during the preparation of a plan and establish security rights for it, without these legal acts being exposed to the risk of avoidance, should the WHOA plan fail and bankruptcy ensue.

In order to obtain court approval: (i) the debtor should initiate the preparation of a restructuring plan and submit the relevant statement to the court; (ii) financing should be essential to ensure the continuity of the debtor's business during restructuring negotiations; and (iii) the legal act in question should benefit the debtor's joint creditors and should not entail any material detriment to any individual creditor. This is typically the case where creditors are likely to be better off under the WHOA plan compared to an alternative (bankruptcy) scenario.[21] Once court approval is secured, the legal act cannot be annulled in future bankruptcy proceedings. Importantly, Article 42a Fw does not make a distinction between external and internal creditors (e.g. group entities), both of which can in principle rely on it.

The operation of Article 42a Fw may be complicated when several group entities are involved in a restructuring attempt. Consider a scenario where one group entity, Company A, obtains financing from the Creditor. As part of this financial arrangement, another group entity, Company B, furnishes a guarantee or collateral to the Creditor. The court presiding over the restructuring of Company A authorises financing under Article 42a Fw. The question is whether the protective shield of the court's approval extends to cover the guarantee and collateral. We argue that this is not the case. Dutch law respects entity separateness.[22] When the court in the proceedings of

21 Rb. Noord-Nederland 26 March 2021, ECLI:NL:RBNNE:2021:1100, r.o. 2.13.

22 Rb. Noord-Holland 19 February 2021, ECLI:NL:RBNHO:2021:1398, *JOR* 2021/101, m.nt. Tollenaar (*Jurlights*). The court observed that "it is questionable whether the law offers the option of offering a plan for several companies in this combined manner. After all, the basic principle is that a separate agreement is offered for each company, in which the individual company identity and separate assets are respected." Separate plans should be submitted for each group entity, except in cases where the restructured debts are covered by the provisions of Article 372 Fw.

Company A assesses whether financing is required to sustain Company A's operations and whether it materially harms the interests of its creditors, it does not have to, and due to practical considerations, cannot evaluate these aspects pertaining to Company B. This is because the latter entity is not subject to the restructuring scheme or the jurisdiction of the court. It is true that Article 372 Fw, discussed in Chapter 10, enables the restructuring of cross-guarantees via a single WHOA plan. However, this article does not deal with transaction avoidance. It only permits a valid (non-annulled) cross-guarantee to be released and contains distinct rules designed to safeguard the interests of a guaranteed creditor.[23]

If the restructuring of Company A fails and Company B enters bankruptcy proceedings, the guarantee and collateral could be subject to the *actio pauliana* challenge by Company B's IP under Article 42 Fw, or, as the case may be, Article 47 Fw. The IP representing Company B may argue that the transactions in question are disadvantageous, since the guarantee has increased the guarantor's liability and the pledged assets are no longer available to its creditors, while all the benefits of the financing were derived by another entity, Company A. Thus, the safe harbour may not give certainty at the moment when the lending decision is made. One might contend that the guarantee itself is covered by the protective shield of Article 42a Fw simply because it is approved by the court as part of the new financing package; the Creditor would not have extended the loan without the guarantee. However, this view is not persuasive as it effectively deprives the guarantor's creditors of the protections conferred by transaction avoidance rules. In other words, it is disproportionate. As noted above, the decision by a judge to approve financing is based on Company A's situation (and that of its creditors), and it does give consideration to the effects on Company B or its creditors, just as the position of the Creditor providing rescue financing is irrelevant for the court's assessment.

This example illustrates the limits of an ex ante approval mechanism within the context of enterprise groups. The reason is that Article 42a Fw, much like Articles 17 and 18 of the EU Restructuring Directive, does not expressly address group restructurings. While the Restructuring Directive mentions that third-party guarantees are covered by financial assistance deserving protection,[24] it does not outline how this can be arranged in practice, especially when the guarantee might adversely affect the guarantor's own creditors. One potential solution can be proposed. The WHOA's flexibility means that it can be used to implement group restructurings. Separate WHOA schemes could be initiated for Company A and Company B. This will enable Article 42a Fw to be invoked for the approval of the loan and the associated guarantee through two parallel yet coordinated WHOA schemes.

23 Dutch Bankruptcy Act, Articles 372 and 384.
24 Restructuring Directive, Recital 66.

In this scenario, the court would be able to consider the implications of the guarantee for Company B's creditors. Consequently, the protection of rescue financing will encompass the whole package of transactions. This also means that the safeguards and requisites contained in Article 42a Fw and other relevant articles of the Dutch Bankruptcy Act will apply to all relevant group members. Admittedly, the opening of separate proceedings is not ideal in view of transaction costs. However, it may be a necessary sacrifice to ensure procedural fairness and substantive protection of creditors' rights.

12.2.3 The USA: DIP financing as a group effort

The special treatment of post-petition or DIP financing in the USA can be traced back to the 19th century large-scale corporate reorganisations, when lenders were afforded special priority for financing reorganisation efforts, often for distressed railroads companies.[25] At that time, loans were used to support businesses during the lengthy restructuring process. Nowadays, DIP financing is considered to be "the most publicized feature of bankruptcy reorganizations."[26] In Chapter 11, it grants a debtor access to the liquidity necessary to finance a restructuring effort, ensuring uninterrupted operating activity and preventing value-depleting piecemeal liquidation. This, among other things, explains the popularity of Chapter 11 among non-US incorporated debtors and their groups.

The rules on DIP financing can be found in §364 of the US Bankruptcy Code. These rules induce new and existing lenders to provide financing to struggling debtors. They do so in several ways with varying degrees of protection and priority, ranging from administrative expense priority to senior secured credit priority. This creates a ladder of priority that courts can authorise if financing cannot be otherwise obtained. The higher the stair (i.e. level of priority), the more demanding the associated conditions become. Without providing a detailed account of the rather complex regulation of DIP financing, it suffices to point out that US law does not make any exceptions related to the composition of rescue financiers. Thus, the benefits of the DIP financing regime are available to insider lenders as well. One recent example illustrating this is the bankruptcy case of LATAM Airlines Group S.A. and some of its group affiliates, in which shareholder DIP financing

25 D.A. Skeel Jr., The Past, Present and Future of Debtor-in-Possession Financing, Cardozo Law Review, Vol. 25, 2004, pp. 1905-1934; D.A. Skeel Jr., Debt's Dominion: A History of Bankruptcy Law in America, Princeton University Press, 2001, p. 48, noting more generally that "the history of corporate reorganization is the history of nineteenth-century railroad failure."

26 G.G. Triantis, A Theory of the Regulation of Debtor-in-Possession Financing, Vanderbilt Law Review, Vol. 46, 1993, p. 901.

was authorised.[27] Nevertheless, despite the fact that the identity of a DIP financier is of lesser importance, courts apply heightened scrutiny when assessing the *bona fides* of transactions involving related parties.[28]

The US approach is quite distinct. Its distinctiveness comes from the practice of group members filing bankruptcy petitions simultaneously to have their cases jointly administered.[29] This "group filing" is made possible by several notable features of US law. First, the US Bankruptcy Code permits a debtor to file for bankruptcy in any bankruptcy court in which a bankruptcy case concerning the debtor's affiliate is pending.[30] This promotes procedural consolidation and enables a single court, or even a single judge, to oversee the restructuring of the entire group. Second, the flexible and COMI-independent jurisdictional criteria to open a Chapter 11 case allow group companies, including foreign affiliates, to implement group restructuring in the USA in a centralised way. There is no requirement that all (or any) group members have their COMI in the USA.[31] Third, Chapter 11 does not mandate material insolvency of a debtor as an entry threshold.[32] As a result, it eliminates the access barrier in the form of the insolvency requirement and thereby permits participation of different group entities, whether solvent or insolvent, in a group reorganisation.[33]

---

27 Order Granting Motion to Approve Debtor in Possession Financing, [ECF No. 1091] *In re LATAM Airlines Group S.A.*, No. 20-11254 (JLG) (Bankr. S.D.N.Y. 2020). The DIP financing involved two existing shareholders, Qatar Airways Investments (U.K.) Ltd and Costa Verde Aeronautica S.A., which held appr. 32% of LATAM's stock.

28 *In re Innkeepers USA Tr.*, 442 B.R. 227 (Bankr. S.D.N.Y. 2010); *In re Papercraft Corp.*, 211 B.R. 813 (W.D. Pa. 1997); *Carlson v. Hallinan*, 925 A.2d 506 (Del. Ch. 2006).

29 S.J. Lubben, American Business Bankruptcy: A Primer, Edward Elgar Publishing, 2021, pp. 109-110.

30 28 U.S. Code § 1408(2). The wide range of permissible bankruptcy venue options, resulting in a concentration of bankruptcy cases in a few districts, attracted some criticism. See the Bankruptcy Venue Reform Act of 2021, which seeks to limit the "affiliate-filing rule".

31 For a bankruptcy jurisdiction, "a dollar, a dime, or a peppercorn" of property in the US suffices. *In re Theresa Mctague* (1996) 198 BR 428, 431. A. Walters, United States' bankruptcy jurisdiction over foreign entities: exorbitant or congruent? Journal of Corporate Law Studies, Vol. 17, 2017, pp. 367-404; G. Ray Warner, Conflicting Norms: Impact of the Model Law on Chapter 11's Global Restructuring Role, International Insolvency Review, Vol. 28, 2019, p. 275, calling the US approach to international insolvency jurisdiction and its global reach "aggressive universalist".

32 P. Blumberg et al., Blumberg on Corporate Groups, 2nd edn, Wolters Kluwer, 2021, § 89.03, observing that "[s]olvency of the subsidiary does not present any hurdle to the institution of voluntary proceedings with respect to the subsidiary and therefore does not present any hurdle to subsequent procedural or substantive consolidation with the proceedings of its insolvent parent."

33 *In re General Growth Properties, Inc.*, 409 B.R. 43, 63 (Bankr. S.D.N.Y. 2009), noting that "a judgment on an issue as sensitive and fact-specific as whether to file a Chapter 11 petition can be based in good faith on consideration of the interests of the group as well as the interests of the individual debtor."

The affiliate-filing rule, flexible jurisdictional standards, and the absence of an insolvency requirement, among other factors, have made the USA a preferred destination for restructurings of enterprise groups. Think of enterprises like Aeromexico, Avianca and LATAM. But most importantly for this section, the above features permit DIP financing to be organised and sanctioned at a group level. In fact, it is common for US courts to approve DIP financing provided to the group, where one group entity acts as the borrower, and other members of the group, each subject to its own bankruptcy proceeding, guarantee the borrower's obligations under the DIP financing.[34]

Before exploring a few examples, it is important to highlight an important feature of US law that ensures the effectiveness of DIP orders and safeguards legal certainty. In Chapter 11, a debtor cannot obtain financing outside the ordinary course of business without a court order.[35] Given that it may not always be obvious if something is done in the ordinary course of business, debtors often seek approval of DIP financing as part of a first-day motion package.[36] Another common motion is a request for the approval of cash management systems.[37] Although the law stipulates that a court may authorise DIP financing *after notice and hearing*, when financing is urgently needed for the continued operation of the business or to protect assets, US courts are willing to authorise it without an actual hearing.[38] The degree of the courts' involvement and control over DIP financing and its terms is limited.[39] What is necessary to point out is that pursuant to the US Bankruptcy Code, if the court authorises DIP financing, any reversal or modification of such authorisation on appeal does not affect the validity of any debt so incurred, or of any priority or lien so granted to an entity that extended such credit in good faith.[40] This "enhanced" safe harbour is of utmost importance

34 *In re Patriot Coal Corp.*, 2012 WL 3728168 (Bankr. S.D.N.Y. 2012); *In re EWGS Intermediary, LLC*, 2013 WL 6978584, at 6 (Bankr. D. Del. 2013), holding that the debtors (group members) have an immediate need to obtain "Post-Petition Financing in order to, among other things, permit the orderly continuation of the operation of their operating businesses, preserve jobs for their employees, maintain vendor support and minimize the disruption of their business operations, manage and preserve the assets of the Debtors' bankruptcy estates […] in order to maximize the recoveries to creditors of the Estates."

35 11 U.S. Code, § 364(b)-(d).

36 Collier on Bankruptcy, 16th edn, 2022, Vol. 10, ¶ 6003.01.

37 *In re Colad Group, Inc.*, 324 B.R. 208, 216-17 (Bankr. W.D.N.Y. 2005).

38 11 U.S. Code § 102(1)(b). *Morlan v. Universal Guar. Life Ins. Co.*, 298 F.3d 609, 618 (7th Cir. 2002), observing that a "notice and a hearing" really means "notice and the opportunity for a hearing".

39 L. Tsioli, Rescue financing under a 'viability spotlight', Journal of Corporate Law Studies, Vol. 22, 2022, p. 851, observing that "the statutory model of DIP financing leaves the court with de facto very little power to restrict excessive creditor control in light of the fear of becoming the one 'stopping the music on a case' […]". The limited involvement of courts makes the role of the creditor's committee (as a watchdog in the DIP process) crucial.

40 11 U.S. Code § 364(e).

for post-petition lenders. It has a practical effect of mooting appeals against orders authorising DIP financing, as long as: (i) the lender or a group of lenders acted in good faith in extending new credit; and (ii) the creditor attempting to challenge the authorisation does not obtain a stay pending an appeal.[41]

An example of a case in which DIP financing was granted at a group level is the restructuring of Babcock and Wilcox Company, Inc. (B&W) and two of its wholly owned subsidiaries. The debtors filed voluntary Chapter 11 petitions, and the court administratively consolidated the cases under Bankruptcy Rule 1015(b). The debtors also submitted a motion seeking authorisation to enter into a post-petition financing arrangement with Citicorp North America, Inc. (CNA). According to this arrangement, the debtors were to receive a USD 300 million revolving line of credit and a letter of credit facility that allowed them to continue doing business. As part of the agreement, CNA would hold a claim against the assets of all the debtors, and this claim would be accorded super-priority administrative expense status. The agreement provided that if any group entity made payments to CNA in excess of the funds actually received by that particular group entity, said entity would acquire a super-priority claim under §364(c)(1) against other debtors, subordinate only to the CNA's claim.

The court approved the DIP financing, finding that it was "necessary to the collective health of the debtors and that all the debtors would benefit from the agreement."[42] This decision was made despite objections of a creditor of one of the group members. This creditor argued that the agreement did not apportion the super-priority administrative expenses based on the amounts actually used by each individual debtor, resulting in de facto substantive consolidation benefitting certain entities and their creditors while disadvantaging others. The court disagreed and concluded that the DIP financing order did not combine the assets or liabilities of the debtors. The group entities effectively acted as guarantors for the post-petition financing. They maintained separate insolvency estates and, as noted above, acquired a super-priority claim against other debtors for any amounts paid to CNA in excess of funds received from it.

---

41 *In re Revco D.S., Inc.*, 901 F.2d 1359, 1364 (6th Cir. 1990). See, however, *In re Swedeland Dev. Group, Inc.*, 16 F.3d 552, 562 (3d Cir. 1994), noting that "[w]e see no reason why section 364(e) should be understood to protect a lender with respect to money it has not disbursed." Also, Collier on Bankruptcy, 16th edn, 2022, Vol. 3, ¶ 364.08, arguing that in "view of the extraordinary protection provided by section 364(e), the better approach is to protect only the lender's actual reliance interest, and not its expectation interest."

42 *Clyde Bergemann, Inc. v. Babcock & Wilcox Co. (In re Babcock & Wilcox Co.)*, 250 F.3d 955, 957 (5th Cir. 2001).

The B&W group case is interesting because it concerns collective post-petition financing for related debtors in cases that are jointly administered but not substantively consolidated.[43] The DIP financing was authorised for the corporate group, with the DIP financier obtaining full recourse and priority against the assets of its constituent members, regardless of which group entity was the ultimate beneficiary of the DIP financing. Widen notes that the practice of approving DIP financing, pursuant to which the DIP lender receives priority in the consolidated assets of a group of companies "recognizes the corporate group as a single entity post-petition for the purposes of obtaining financing" and "creates the equivalent of an intercompany family of guarantees to protect the DIP lender."[44]

To conclude, ex ante authorisation of rescue financing can be a valuable addition to ex post judicial review. Yet it cannot and should not fully substitute such ex post review, as it plays a crucial role in safeguarding creditors' rights and remains a fallback option. The effectiveness of a safe harbour as a tool to ensure legal certainty, promote intra-group financing in a crisis, and filter and prevent opportunistic and harmful transactions depends on the design and implementation of the safe harbour. As Rodion Raskolnikov from Dostoevsky's Crime and Punishment (1866) points out, "Trifles, trifles are what matter! Why, it's just such trifles that always ruin everything" (in Russian: "*Мелочи, мелочи главное!.. Вот эти-то мелочи и губят всегда и всё...*"). As is often the case, the devil is in the details. This is also true for using a safe harbour within a group context. If a safe does not accurately reflect the group reality, its efficiency may be limited. This is because it could fail to establish a balance between the interests of individual group entities and their creditors.

If restructuring and the attraction of rescue financing constitute a team (group) effort, relevant group entities should be involved in the authorisation process, and creditors of such group entities should be sufficiently protected. Whether this is achievable in practice depends on a variety of factors, from rules on international insolvency jurisdiction (e.g. whether a centralised group solution is possible) to the specific conditions for accessing restructuring or insolvency proceedings (e.g. whether insolvency is a prerequisite). In this respect, the US Bankruptcy Code offers a framework facilitating group restructuring efforts and intra-group DIP financing as their integral part. It has the whole package, including welcoming jurisdictional standards, low bar for entry, procedural consolidation, and the "enhanced" safe harbour resulting from court authorisation of DIP financing.

---

43 For a similar DIP financing arrangement involving intercompany guarantees, see *In re Solidus Networks, Inc.*, Not Reported in B.R., 2008 WL 8462968 (9th Cir. BAP 2008).

44 W.H. Widen, Prevalence of Substantive Consolidation in Large Bankruptcies from 2000 to 2004: Preliminary Results, American Bankruptcy Institute Law Review, Vol. 14, 2006, p. 57.

12.3 Pre-emptive Financial Arrangements in Banking Groups

12.3.1 Bank resolution: from reaction to pre-emption

The previous sections discussed the strategy of ex ante authorisation of rescue financing, which applies when an entity experiences financial distress and requires access to rescue financing. In other words, it is an ad hoc crisis-triggered strategy. By contrast, after the Global Financial Crisis, the focus of legislators in the EU and other regions shifted from a reactive approach to a pre-emptive and proactive one, especially in the area of bank regulation. Unlike ad hoc strategies, proactive enhancements are devised and implemented when there are no signs of financial distress or insolvency. The rationale behind this anticipatory crisis preparation is rooted in the recognition that no business is immune to insolvency, and that failures are almost inevitable in complex systems.[45] The GFC is exemplary in this respect. It is therefore logical to make systems less complex and limit the negative consequences of their failures. One way to achieve this is through group recovery and resolution planning.

The requirement for banks to adopt recovery or resolution plans, colloquially known as "living wills", was introduced both in the USA[46] and the EU.[47] There are several important reasons for having living wills.[48] First, detailed and up-to-date plans provide resolution and other authorities with the necessary information for efficient monitoring, timely early intervention, and the execution of resolution tools. Second, these plans play an educational and disciplining role, and improve the awareness of banks' own directors about potential problems or weaknesses.[49] As a result, they can serve as warning indicators and catalysts for addressing impediments to the resolvability of a credit institution or a banking group. This might involve the enhancement of the corporate and financial structure of the group, its business lines, and the division of tasks within the group. Third,

45 S.L. Schwarcz, Regulating Complexity in Financial Markets, Washington University Law Review, Vol. 87, 2009, p. 248.

46 Dodd-Frank Act, Section 165(d). US law does not separate recovery and resolution planning.

47 BRRD, Title II. Under the BRRD, recovery plans are drawn up by banks themselves, while resolution plans are prepared by the Single Resolution Board and national resolution authorities. In contrast, under the Dodd-Frank Act, banks must draft resolution plans and submit them to the Federal Reserve Board, the Financial Stability Oversight Council and the Federal Deposit Insurance Corporation.

48 Some scholars remain sceptical of the practical relevance of recovery and resolution planning. S.L. Schwarcz, Beyond Bankruptcy: Resolution as a Macroprudential Regulatory Tool, Notre Dame Law Review, Vol. 94, 2018, p. 719, commenting: "In my many years as a workout and bankruptcy lawyer, I rarely saw a firm's failure that accurately reflected, much less closely resembled, expectations about the firm when it was profitable."

49 M. Ventoruzzo, G. Sandrelli, O Tell Me the Truth about Bail-In: Theory and Practice, Journal of Business, Entrepreneurship & the Law, Vol. 13, 2020, p. 218.

crisis preparation and the disclosure of information in plans can "clarify expectations and strengthen market confidence in the resolution actions of authorities."[50] Fourth, living wills can contribute to simplifying relations and reducing complexity in multi-layered and multi-national banking groups.[51] This complexity is frequently driven by extensive intra-group transactions.[52]

Among other elements, according to EU law, group recovery plans should contain a detailed description of the group's legal and financial structure and an explanation of internal (intra-group) interconnectedness. In particular, this "interconnectedness" covers material intra-group exposures and financial arrangements, such as cross-guarantees, legal interconnectedness arising from material legally binding agreements between group companies, and operational interconnectedness related to the division and centralisation of functions among group entities, which are important for other entities in the group, such as centralised IT functions, treasury functions, risk functions or administrative functions.[53]

The requirement to prepare living wills is not the only tool reflecting a post-GFC shift to pre-emption. This shift is also evident in the way intra-group support and intra-group obligations are (pre-)arranged or (pre-)positioned within banking groups. There are different mechanisms to ensure that sufficient capital and liquidity are available to members of a banking group in a crisis situation. One such mechanism is a group financial support agreement, introduced in the EU by the BRRD. Other preparatory strategies

50 FSB, Public Disclosure on Resolution Planning and Resolvability. Discussion Paper for Public Consultation, June 3, 2019. In the EU, recovery and resolution plans are not publicly available. Yet some information contained therein must be revealed, such as general terms of group financial support agreements. In the USA, resolution plans consist of a private section containing confidential supervisory and proprietary information that is not available to the public, and an open public section.

51 E. Avgouleas, C. Goodhart and D. Schoenmaker, Bank Resolution Plans as a catalyst for global financial reform, Journal of Financial Stability, Vol. 9, 2013, p. 211, attributing the complexity of banking group structures to banks' desire to exploit the benefits of the legal structure (e.g. regulatory and tax arbitrage) and take advantage of the synergies attached to operating as an integrated group (e.g. intra-group transactions).

52 J-H. Binder, Resolution Planning and Structural Bank Reform within the Banking Union, SAFE Working Paper No. 81, 2014, p. 6.

53 Commission Delegated Regulation (EU) 2016/1075 of 23 March 2016 supplementing Directive 2014/59/EU of the European Parliament and of the Council with regard to regulatory technical standards specifying the content of recovery plans, resolution plans and group resolution plans, the minimum criteria that the competent authority is to assess as regards recovery plans and group recovery plans, the conditions for group financial support, the requirements for independent valuers, the contractual recognition of write-down and conversion powers, the procedures and contents of notification requirements and of notice of suspension and the operational functioning of the resolution colleges [2016] OJ L 184/1, Article 7(1)(c).

relate to the pre-positioning of financial resources in subsidiaries and various organisational (structural) and contractual arrangements supporting such pre-positioning. These mechanisms aim to create a predictable and manageable framework for recovery and resolution of banking groups. Whether they achieve this goal is debatable. It suffices to point out that advance planning differentiates them from the ad hoc (authorisation) and ex post (judicial review) strategies explored elsewhere.

12.3.2 Group financial support agreements under the BRRD

Intra-group financing within banking groups is described as "large, volatile and heavily relied upon around the world."[54] Yet during the GFC, many jurisdictions imposed or tightened restrictions on intra-group transfers, thereby limiting the ability of banking groups to optimally re-allocate funds from a group company with excess capital and liquidity to those group entities that needed them.[55] This was attributed to the policy of insulation and geographical ring-fencing, employed by the states to protect local (national) interests (for the case of Icelandic banks, see section 3.4.2.).

The BRRD recognises that the provision of financial support and assistance between entities within a cross-border banking group may face constraints in a situation of a financial crisis.[56] Some restrictions are found in national and EU law (e.g. individual application of liquidity requirements, large exposure limits). These restrictions are designed to prevent crises, mitigate cross-border contagion, reduce intra-group exposures, protect local creditors and other stakeholders. Alongside these restrictions, general transaction avoidance rules, largely unharmonized across the EU, and the risk of director liability create additional, more covert, obstacles for the continuity of intra-group financing, where one of the parties involved in an intra-group support transaction is in the vicinity of insolvency.[57]

---

54 D. Reinhardt and S.J. Riddiough, The Two Faces of Cross-Border Banking Flows, IMF Economic Review, Vol. 63, 2015, p. 781.

55 E. Cerutti et al., Bankers Without Borders? Implications of Ring-Fencing for European Cross-Border Banks, in L.L. Ong (ed), A Guide to IMF Stress Testing: Methods and Models, 2014, p. 152; EC, Study on the feasibility of reducing obstacles to the transfer of assets within a cross border banking group during a financial crisis, Final Report, 2010.

56 BRRD, Recital 38.

57 A. Campbell and P. Moffatt, Large scale bank insolvencies and the challenges ahead, in M. Haentjens and B. Wessels (eds), Research Handbook on Crisis Management in the Banking Sector, Edward Elgar Publishing, 2015, p. 64, observing that in the context of banking groups, problems tend to arise "where local transaction avoidance provisions render intra-group transactions (such as those relating to preferential payments, or the transfer of assets at an undervalue and so forth) void."

In 2012, the European Commission recognised the problem and explored various policy responses, ranging from 'no policy change' (baseline scenario) to the introduction of the concept of "group interest" in company laws of EU countries.[58] Another alternative considered was the conclusion of a voluntary agreement on group financial support and its supervisory approval. The results of a public consultation on these options were mixed. It was accepted that the introduction of "group interest" in related-party transactions could undermine limited liability and blur the boundaries between group companies. However, the establishment of a special tool in the form of a voluntary agreement for intra-group financing, referred to as a "pre-emptive transaction", was generally supported.[59] It was noted that such a tool would alleviate concerns regarding directors' liability, minimise the risks of transaction avoidance and increase clarity for transacting parties. In line with this, the BRRD introduced a special framework called "Group Financial Support Agreement" (GFSA).

A GFSA is entered pre-emptively. It does not involve an immediate transfer of funds or the granting a guarantee or collateral. Instead, it could be seen as a commitment or promise to provide support if the conditions for such support are satisfied in the future. This is why a GFSA can only be concluded if the parties (i.e. group companies) do not meet the conditions for early intervention, such as the infringement or likely infringement of prudential or conduct of business requirements.[60] While the GFSA itself should be concluded pre-emptively, the actual provision of support must be carried out in an early intervention scenario. Hence, business-as-usual transfers do not fall within the scope of the BRRD's protective regime for intra-group financial support.[61] We will now delve into the key features of this supranational regime.

First, the rationale behind GFSAs should be clarified. The BRRD recognises the need for a special regulatory framework to ensure financial stability of banking groups.[62] Without it, the rules of national law (e.g. local regulatory requirements for liquidity/capital) may restrict the ability of group entities to support each other in times of financial distress. Consequently, the efficient use of group resources might be prevented. Some group entities may be cash-rich and can serve as a source of funds for other group members,

58 Impact Assessment accompanying the document – Proposal for a Directive establishing a framework for the recovery and resolution of credit institutions and investment firms, SWD(2012) 166 final.

59 Ibid.

60 BRRD, Articles 19(8) and 27(1). EBA, Guidelines on triggers for use of early intervention measures pursuant to Article 27(4) of Directive 2014/59/EU, 2015.

61 BRRD, Article 19(3), stating that a GFSA shall not constitute a prerequisite to provide group financial support to a distressed group entity "on a case-by-case basis and according to the group policies if it does not represent a risk for the whole group."

62 BRRD, Recital 38.

helping them navigate through asymmetric and idiosyncratic shocks. The political side is also important. The GFC uncovered home-host tensions and exposed local ring-fencing, challenging the practice of centralised capital and liquidity management by cross-border banking groups.[63] The existence of a pre-approved support agreement, such as a GFSA, could (in theory) encourage cooperation between competent authorities in a crisis.

Second, once a GFSA is concluded and approved, its execution must not be inhibited by "any legal impediment in national law."[64] This creates a safe harbour against various impediments, including those arising from insolvency-related transaction avoidance.

Third, intra-group support may only be provided if several conditions are satisfied. For instance, there should be a reasonable prospect that the support will redress financial difficulties of the receiving group company.[65] The support should aim to preserve or restore the financial stability of the entire group or any of its members, and must be in the interests of the group member providing support.[66] Importantly, when assessing the interests of the providing entity (i.e. the grantor of financial support), both direct and *indirect* benefits arising from the restoration of financial soundness of the receiving entity and the preservation of group synergies can be taken into account. The EBA acknowledges that indirect benefits are difficult to quantify, for instance, when they concern limiting potential damage to the franchise and reputation that may occur if a group member is allowed to fail.[67] Finally, the liquidity and solvency of the providing entity shall not be compromised as a result of extending support.[68] Therefore, the providing entity should not sacrifice itself and its creditors for the sake of group interests (section 3.5.1.).

Fourth, the procedure for concluding and executing a GFSA is complex.[69] There are in fact two separate procedures or stages. The first stage concerns the approval of a GFSA. It commences with the parent entity submitting an

---

63 D. Schoenmaker, Governance of International Banking: The Financial Trilemma, OUP, 2013, Ch. 4.2; P. Davies, Resolution of cross-border groups, in M. Haentjens, B. Wessels (eds), Research Handbook on Crisis Management in the Banking Sector, Edward Elgar Publishing, 2015, pp. 263-265.

64 BRRD, Article 19(4).

65 BRRD, Article 23(1)(a).

66 BRRD, Article 23(1)(b).

67 EBA, Guidelines specifying the conditions for group financial support under Article 23 of Directive 2014/59/EU, 2015.

68 BRRD, Article 23(1)(e). Yet non-compliance with prudential requirements for capital, liquidity and large exposures can be authorized in exceptional circumstances. See BRRD, Article 23(1)(g).

69 M. Schillig, Resolution and Insolvency of Banks and Financial Institutions, OUP, 2016, p. 191, observing that the process for approving and executing group financial support agreements is "unsuitable to adequately address a crisis situation."

application for the authorisation of the GFSA to the consolidating supervisor.[70] This application is then transmitted to the competent authorities of the entities involved, with a view to reaching a joint decision.[71] If no such decision is reached within four months, the consolidating supervisor must make its own decision on the application. The matter could also be referred to the EBA, which would then make the final decision. Following authorisation, a GFSA needs to be approved by shareholders of the relevant group entities.[72] The second stage pertains to the approval of the actual extension of financial support (e.g. transfer of funds). It includes the decision by the management of both the providing entity and the receiving entity,[73] as well as non-opposition from the competent authorities.[74]

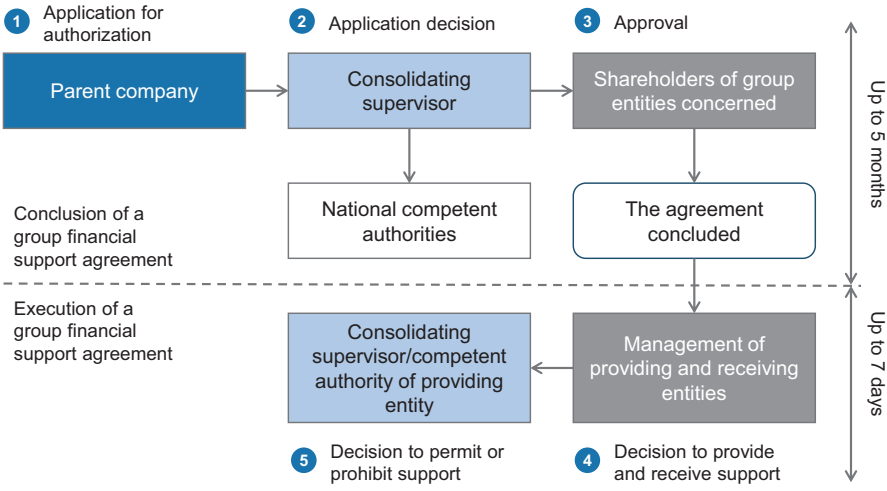

Figure 15. Approval and authorisation of intra-group financial support under the BRRD

To sum up, a GFSA offers a harmonised, relatively clear and transparent framework for intra-group financial support, which could contribute to the optimal allocation of resources within banking groups and ensure the continued operation of banking subsidiaries. However, writing in 2020, approximately five years after the BRRD entered into force, Gardella et al. concluded that the majority of banks active in the EU did not set up a GFSA,

70 The consolidating supervisor is the lead supervisor in the group oversight context. Within the euro area, the ECB is the consolidating supervisor. For a definition, see Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012, Article 4(1)(41).

71 BRRD, Article 20.

72 BRRD, Article 21.

73 BRRD, Article 24.

74 BRRD, Article 25.

as they did not consider it to be a suitable tool.[75] This may be attributed to the complex, cumbersome, and inflexible rules governing the establishment and execution of GFSAs in crisis scenarios. Another drawback of the GFSA regime is that it does not oblige group entities to enter into GFSAs,[76] nor does it mandate their execution or empower supervisory authorities to demand intra-group support if the providing entity is not subject to early intervention.[77] Furthermore, the fact that a GFSA is concluded long before its potential execution can render it less suitable for a given crisis – a time-inconsistency problem.[78]

12.3.3 Prepositioning of loss absorbing capacity within banking groups

To ensure the internalisation of losses in the event of a bank failure and to prevent public bailouts, the BRRD establishes rules on a minimum requirement for own funds and eligible liabilities (MREL).[79] These rules are designed to ensure sufficient loss-absorbing and recapitalisation capacity available in resolution, such that the costs of a failure are borne by the bank's investors (e.g. shareholders and creditors) rather than depositors or taxpayers. The internalisation of losses is an essential pillar of modern bank resolution frameworks. A requirement similar to MREL was developed by the FSB for global systemically important banks (G-SIBs). It is called total loss absorbing capacity or TLAC.[80] Both MREL and TLAC are closely connected to the two prevailing strategies or models of bank resolution: the multiple point of entry model and the single point of entry model.

The MPOE model entails intervention by multiple resolution authorities and the application of resolution measures at the level of operating subsidiaries. This model may be more suitable for banking groups consisting of

---

75 A. Gardella, M. Rimarchi and D. Stroppa, Potential regulatory obstacles to cross-border mergers and acquisitions in the EU banking sector, EBA Staff Paper Series No. 7, 2020, p. 28.

76 M. Schillig, Resolution and Insolvency of Banks and Financial Institutions, OUP, 2016, para. 7.50, arguing that this is "a major drawback in the BRRD regime." EBA, Final Report on Recommendation on the coverage of entities in a group recovery plan, 2017, observing that the existence of a group support agreement would certainly help address the situation of financial distress and confirming that it is up to the institution to decide whether to include them as a recovery measure in a recovery plan.

77 D. Ramos Muñoz, M. Lamandini, Evolving key risks in the banking sector and related priorities for the SRB: the lack of an effective transfer-based bank crisis framework, November 2022, p. 9.

78 Time-inconsistency or dynamic inconsistency problem occurs when "the best policy planned currently for some future period is no longer the best when that period arrives." A. Cukierman, Central Bank Strategy, Credibility, and Independence: Theory and Evidence, MIT Press, 1992, p 15.

79 BRRD, Article 45.

80 FSB, Principles on Loss-absorbing and Recapitalisation Capacity of G-SIBs in Resolution. Total Loss-absorbing Capacity (TLAC) Term Sheet, 2015.

operating subsidiaries with limited interconnections to other group companies. Conversely, pursuant to the SPOE model, resolution powers (bail-in, bridge institution tool, etc.) are executed at the level of a holding company at the top of the group or a sub-group (i.e. resolution group).[81] This model is likely to be selected by resolution authorities for centrally structured and operated groups, particularly when material subsidiaries depend on funding from the parent company and the parent company is capable of absorbing losses from its subsidiaries. The gist of the SPOE strategy is to avoid disruption in the activities of group operating subsidiaries and to mitigate the risk of bank runs at the subsidiary level.[82] The BRRD is choice-neutral and equally accepts SPOE and MPOE resolution models.[83] Yet given the level of integration within banking groups in the Banking Union and among G-SIBs, resolution authorities are likely to choose the SPOE model.[84]

To clarify some terms used above, "resolution entities" are group entities to which resolution actions are applied and which are subjects to the rules on "external MREL". Resolution entities, together with their subsidiaries that are not resolution entities, comprise "resolution groups". External MREL refers to debt instruments (mainly bonds) issued by the resolution entity to third parties (non-group persons). In a crisis situation, these third parties suffer losses first. Their claims might be written down or converted into equity as part of a bail-in. Thus, external MREL refers to the external loss absorbing capacity of a banking group. By contrast, "internal MREL" relates to the capacity to up-stream losses from operating subsidiaries to the resolution entity. It requires the issuance (prepositioning) of "loss-absorbing" debt instruments from the former to the latter. These instruments should be capable of being written off if required, allowing losses to be passed to the resolution entity. Viewed from this perspective, internal MREL may be considered a type of intra-group support, because it entails up-streaming of losses from the subsidiary to the parent or resolution entity. The amount of internal pre-positioned MREL should give comfort to local authorities that

81 Directive (EU) 2019/879 of 20 May 2019 amending Directive 2014/59/EU as regards the loss-absorbing and recapitalisation capacity of credit institutions and investment firms (BRRD 2).

82 P.L. Lee, Bankruptcy Alternatives to Title II of the Dodd-Frank Act – Part I, The Banking Law Journal, Vol. 132, 2015, p. 464; J.F. Bovenzi, R.D. Guynn and T.H. Jackson, Too Big to Fail: The Path to a Solution, Economic Policy Program Financial Regulatory Reform Initiative, 2013, pp. 23-32; D.A. Skeel, The new synthesis of bank regulation and bankruptcy in the Dodd-Frank era, in B.E. Adler (ed), Research Handbook on Corporate Bankruptcy Law, Edward Elgar Publishing, 2020, pp. 79-82, discussing benefits and potential problems of the SPOE approach.

83 BRRD, Recital 80.

84 I.A. Fontán et al., Banking Supervision and Resolution in the EU: Effects on Small Host Countries in Central, Eastern and South Eastern Europe, World Bank Group Working Paper, 2019, p. 21, observing that the "SPE is the predominant resolution strategy agreed among resolution authorities for G-SIBs and also for banking groups within the banking union."

adequate resources are available to absorb losses and meet recapitalisation needs of the operating subsidiaries.

There are two potential problems associated with the pre-positioning of internal MREL within banking groups. First, such prepositioning is costly and may restrict the transferability of resources within the group.[85] Second, the prepositioned resources could prove insufficient to cover losses at the subsidiary level and guarantee the uninterrupted operation of subsidiaries. Recapitalisation achieved through the cancellation and/or conversion of debt instruments that meet the conditions for internal MREL does not per se result in the provision of additional funds, which may be necessary to support such uninterrupted operation, especially if banking subsidiaries experience a bank run. The current EU regulatory framework does not impose an obligation on a parent company or resolution entity to extend further support to subsidiaries.[86] Besides, as noted above, national law could limit such support.

12.3.4 Structural and contractual arrangements related to intra-group support

The question is whether an alternative solution can be found to reduce the need for relatively high levels of pre-positioned resources and to secure a pool of readily available resources that can be employed in a flexible manner to address capital shortfalls in different parts of a cross-border banking group. Different tools are embraced to ensure the support of operating subsidiaries and to mitigate the risk that legal, regulatory, or operational barriers impede intra-group transfers. This section discusses relevant structural and contractual arrangements.

Recent amendments to the BRRD (BRRD 2) and the SRMR (SRMR 2)[87] make it possible to substitute the costly option of pre-positioning with the less costly commitment of a top company (resolution entity) to financially assist its subsidiary. Thus, a resolution authority of a subsidiary – a non-resolution entity – can waive internal MREL requirements for that subsidiary under certain conditions. Such a waiver is possible if both the resolution

85 E. König, Single Point of Entry – a resolution strategy addressing the home – host issue in Europe's Banking Union, The SRB Blog, 22 April 2021, commenting that while the BRRD sets a prudent internal MREL requirement, it comes at a price, "as it may lead to the fragmentation of the financial resources of internationally active groups."

86 M. Dewatripont, M. Montigny and G. Nguyen, When trust is not enough: Bank resolution, SPE, Ring-fencing and group support, ECGI Finance Working Paper No. 759/2021, 2021, p. 11.

87 Regulation (EU) 2019/877 of the European Parliament and of the Council of 20 May 2019 amending Regulation (EU) No 806/2014 as regards the loss-absorbing and recapitalisation capacity of credit institutions and investment firms.

entity and its subsidiary are established in the same EU state, if they are part of the same resolution group, and if "there is no current or foreseen material practical or legal impediment to the prompt transfer of funds or repayment of liabilities by the resolution entity to the subsidiary".[88] The law does not clarify what "material practical or legal impediments" are. This lack of clarity has already led to some disputes resolved by the SRB Appeal Panel.[89] Among relevant considerations for the analysis of possible impediments to intra-group transfers, the SRB mentions national company and insolvency laws, the legal structure of the banking group, by-laws and shareholder agreements that may obstruct the transfer of funds or repayment of liabilities by the parent company.[90] A functional substitute to internal MREL is a contractual commitment from the parent company to provide financial assistance to the subsidiary, e.g. via a downstream guarantee.[91] This guarantee is an alternative to the prepositioning of internal MREL, yielding comparable effects. If used, it can offer a degree of flexibility to complement fully prepositioned instruments to meet the internal MREL requirements.

In the USA, contractually binding mechanisms take the form of secured support agreements (SSAs), in which a non-operating holding company, known as intermediate holding company or IHC, assumes an obligation to extend pre-bankruptcy support to material subsidiaries. This support is backed by perfected security interests in collateral granted by the IHC. To enable this arrangement, the IHC is prefunded with resources from a parent company and maintains a liquidity and capital buffer that can be deployed upon a resolution event. The primary objective of this structural setup is to guarantee the uninterrupted going-concern operation of subsidiaries throughout the resolution process. The operation of SSAs aligns with the SPOE model, prevalent among large US banks. This is the result of various regulatory, taxation and accounting policies.[92] SSAs are utilised by many G-SIBs, including Bank of America,[93] Citigroup,[94] JPMorgan Chase & Co,[95] Goldman Sachs,[96]

88 BRRD 2, Article 45f; SRMR 2, Article 12h.
89 SRB Appeal Panel, Final decision, Case 1/2021, 29 June 2022; SRB Appeal Panel, Final decision, Case 2/2021, 27 January 2022; SRB Appeal Panel, Final decision, Case 3/2021, 8 June 2022.
90 SRB, Minimum requirement for own funds and eligible liabilities (MREL), June 2022, Annex II.
91 BRRD 2, Article 45f(5); SRMR 2, Article 12g(3).
92 J. Carmassi and R.J. Herring, The Corporate Complexity of Global Systemically Important Banks, Journal of Financial Services Research, Vol. 49, 2016, p. 175.
93 Bank of America Corporation 2023 Resolution Plan Submission.
94 Citigroup Inc. 2023 Resolution Plan, Public Section, July 1, 2023.
95 JPMorgan Chase & Co, 2023 Resolution Plan Public Filing.
96 The Goldman Sachs Group, Inc. 2023 Resolution Plan, Public Section.

Morgan Stanley[97] and Bank of New York Mellon.[98] All these banks adhere to the SPOE model, which contributes to legal, managerial, and financial centralisation.

For illustrative purposes, the figure below shows the functioning of the Support Agreement, as presented in the resolution plan of JPMorgan Chase & Co. According to it, (i) before the parent company's board votes to file a Chapter 11 petition, the parent company is contractually obliged to downstream certain of its remaining assets to IHC; (ii) IHC undertakes to provide the necessary capital and/or liquidity support to the main bank (JPMCB), and to other key subsidiaries whose pre-positioned resources are insufficient to meet the needs for capital and liquidity in resolution; and (iii) IHC's obligations to provide capital or/and liquidity support are secured by security interest over its assets, so that breach of the secured Support Agreement would give rise to a secured claim based on an agreed-upon damages provision, which would at a minimum be equal to, and could potentially be in excess of, the support obligations. As such, breaching the Support Agreement is meant to cause detriment to IHC.

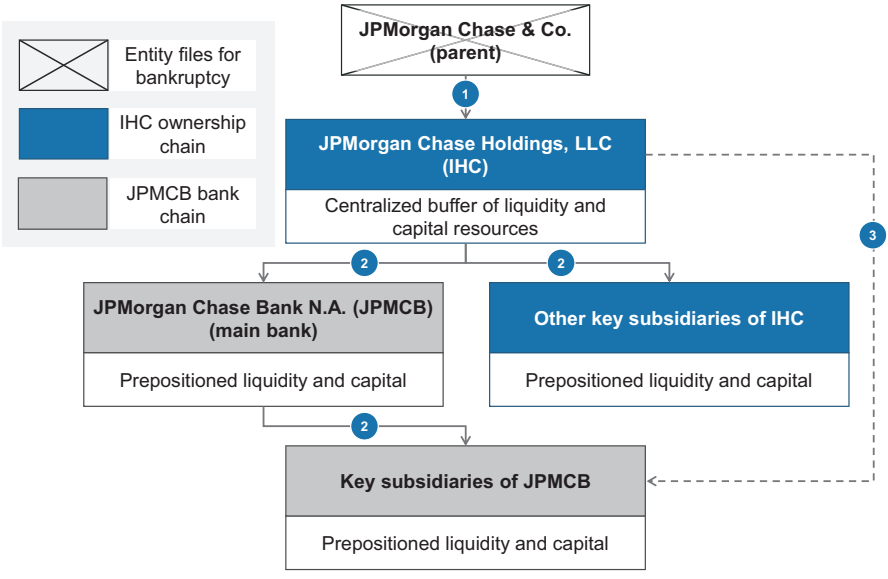

Figure 16. Support agreement under the resolution plan of JPMorgan Chase & Co[99]

97 Morgan Stanley 2023 Resolution Plan, Public Section.

98 BNY Mellon, Resolution Plan, Public Section, 1 July 2023. Interestingly, BNY Mellon used the MPOE model in the 2015 Resolution Plan but opted for the SPOE model in its 2016 resolution plan submission. The same transition to the SPOE model was also made by Wells Fargo in its 2019 plan.

99 This figure is based on JPMorgan Chase & Co, 2023 Targeted Resolution Plan, Public Filing, p. 40.

The legal and operational structure of a banking group and the overall approach to resolution cannot be dealt with in isolation.[100] The SPOE model is preferable when the operations of group entities are integrated and when there is a potential for group-wide contagion. This is common in groups that have centralised corporate and financial structures. For example, in the USA, banking groups historically have a top-level holding company, whose capital structure includes bonds and other long-term unsecured debt, while short-term debt and operations are concentrated in subsidiaries.[101] Conversely, the MPOE model may be more appropriate for decentralised banking groups. Under this model, intra-group support agreements such as SSAs or intercompany guarantees might be less feasible, to the extent that the MPOE model seeks to limit financial interconnections and preserve the separateness of entities in resolution.

Apart from these observations, one should keep in mind that contractual arrangements are intended to complement, rather than replace, the pre-positioning of resources within group entities. They serve to enhance the existing MREL/TLAC regime by introducing flexibility and freeing some resources to be directed where and when they are needed. Arguably, contractual arrangements do not provide the same degree of certainty and predictability as pre-positioned resources. Their effectiveness hinges on two critical assumptions: (i) the availability and sufficiency of resources to be transferred from the parent to its subsidiaries ensuring seamless operations, and (ii) the enforceability of support agreements and their insolvency-proofness. Such enforceability and insolvency-proofness depend on applicable contract and insolvency law.

12.4 Conclusions and Suggestions

12.4.1 Overview of main findings

Regulating financial support within enterprise groups is a difficult task due to the complexity of intra-group relations, the variety of operational and financial arrangements among group members, entity bias in company and insolvency law, and the risk of opportunistic behaviour by group members.

100 D. Schoenmaker, The impact of the legal and operational structures of euro-area banks on their resolvability, Policy Contribution, Issue 23, 2016, p. 6; P. Bolton and M. Oehmke, Bank Resolution and the Structure of Global Banks, The Review of Financial Studies, Vol. 32, 2019, p. 2415, highlighting the need for complementarity between a bank resolution strategy and the structure of global banks.

101 D.A. Skeel, Single Point of Entry and the Bankruptcy Alternative, in M.N. Baily and J.B. Taylor (eds), Across the Great Divide: New Perspectives on the Financial Crisis, Hoover Press, 2014, p. 313, noting that this structure of the US financial groups "is in large part a historical accident, caused by restrictions on banks' ability to branch across state lines and other regulatory obstacles."

The preceding chapters have identified two issues specific to intra-group financing. Chapter 7 explored the effects of the statutory subordination of intra-group loans, while Chapter 8 shed light on the challenges of ex post review of transactions involving group members. Both statutory subordination and transaction avoidance significantly increase the risk for parties extending financing. This chapter discussed two strategies that may be used to facilitate efficient intra-group rescue financing: safe harbours and pre-emptive structural and contractual arrangements.

English law does not have a well-developed statutory framework promoting rescue financing. In contrast, Dutch and US laws contain rules on ex ante authorisation of rescue financing, applicable in WHOA schemes and Chapter 11 plans. Dutch law permits the court to approve a legal act necessary to sustain the debtor's operations during WHOA plan preparation. Once approved, this act gains immunity from transaction avoidance. However, as we have shown, the court's approval of a legal act, such as a loan to the principal debtor (a scheme company), does not necessarily give protection for any accompanying transaction, such as a guarantee extended by a group member, which itself is not subject to the WHOA scheme. Should such a guarantor subsequently face bankruptcy, the likelihood of the guarantee being contested is considerable (section 8.2.4.). As for US law, the US Bankruptcy Code contains detailed rules on DIP financing, which equally apply to intra-group DIP financing. Yet transactions involving affiliates are subject to heightened scrutiny based on the "entire fairness" standard. Notably, US courts allow DIP financing to be organised and sanctioned at a group level. Typically, this occurs when group companies file bankruptcy petitions "in one go" and request the court to issue a first-day order approving DIP financing for the entire group, at least on a preliminary basis.

The second part of this chapter analysed various crisis preparation and pre-emption strategies. These strategies mainly apply to banking groups, as banks are subject to specific prudential and resolution requirements, including obligations related to the pre-positioning of resources and liabilities in group entities (i.e. external and internal MREL/TLAC). The need to promote efficient allocation of capital and liquidity within a banking group has led to a plethora of tools and strategies, ranging from a detailed framework for group financial support agreements (GFSAs) laid down in the BRRD, to structural and contractual arrangements affecting intra-group financing. The latter include the establishment of "buffer" intermediate holding companies, intra-group guarantees, and secured support agreements. These pre-emptive strategies reflect two, at times conflicting, perspectives. One perspective facilitates the integrated management of capital and liquidity in the banking group, allowing the group to allocate resources where they are most needed. This is the perspective of "flexibility and efficiency" of intra-group financing, better served by *contractual* support arrangements. These are very common among large US banks. Yet questions remain about

their effectiveness and enforceability during a crisis. Another perspective prioritizes "legal certainty and predictability". It is promoted by prepositioning, wherein resources are locked up in separate group entities. While facilitating resolvability, ensuring certainty and enhancing protection of national financial interests, it may freeze resources that could otherwise be freely used elsewhere in the group. When choosing between these two perspectives, one is effectively navigating between Scylla and Charybdis.

12.4.2 Suggestions on dealing with intra-group rescue financing

Based on an overview of different approaches to intra-group rescue financing and building on our findings outlined above and in Chapters 7 and 8, the following suggestions are offered regarding intra-group recue financing in an insolvency context.

First, when applying transaction avoidance rules to transactions involving group members, such as cross-guarantees, and specifically when determining the associated benefits and detriments of any given transaction, group considerations and group interest must be taken into account. This group-conscious application of the law is necessarily fact-intensive and involves the assessment of different characteristics of an enterprise group and its financial distress. Some factors that may be considered include:

- group integration and interconnectedness;
- the allocation of roles and functions among companies within the group;
- the presence of other guarantors and *in rem* security interests, which can benefit the guarantor and reduce its risks (e.g. due to subrogation or indemnity claims);
- the economic viability of an entity receiving financial support;
- external and internal causes contributing to financial difficulties;
- current market conditions and potential adverse trends; and
- the likely consequences of extending and withholding financial support.

When reviewing these factors, it is important to bear in mind that group interest alone cannot warrant the deprivation or sacrifice of the rights and interests of creditors of individual group members (section 3.5.2.).

Second, even if group considerations are integrated into the analysis and facilitate efficient intra-group financing, thereby promoting the principle of (group) value maximisation, they cannot eliminate the legal uncertainty inherent in ex post judicial review. The greater the complexity of the legal assessment and the number of factors involved, the more scope there is for judicial discretion. To promote the principle of protection of legitimate expectations and trust (section 4.3.2.), a strategy of ex ante authorisation of legal acts may be embraced. Once authorised, a legal act (e.g. an intra-group loan or a cross-guarantee securing it) is shielded from future avoidance

actions. This legal act falls within a "safe harbour". If so prescribed, the authorisation can also "deactivate" statutory subordination or even confer priority to rescue financing.

When designing a safe harbour, different rules should be formulated for financing necessary to continue the debtor's operations during negotiations with creditors (i.e. interim financing) and for financing required to implement a restructuring plan (i.e. new financing). While for interim financing, due to its urgency, the decision-making power could be vested in the court, the approval of new financing should be primarily left to the affected creditors. This is because these creditors are the ultimate risk-bearers. In other words, they have "skin in the game" and stand to incur losses if the (group) restructuring fails. Moreover, in a situation of uncertainty, the decision theory suggests that a collective decision made by a large and diverse group of persons like creditors is preferred to a decision made by a single expert, such as a judge.[102]

In their recent book, Bork and Veder are critical of both restructuring privileges and ex ante authorisation of transactions.[103] Their critique primarily revolves around two key points.

First, Bork and Veder observe that in view of the rescue financier's awareness of the debtor's substantive insolvency, which is interpreted to include likely insolvency at some point in the future, the principle of protection of trust and legitimate expectations of creditors is triggered to a lesser degree, if at all.[104] While it is true that the existence of the risk itself is foreseeable and undisputed, determining its extent could be challenging. We note that the awareness of the debtor's financial distress or prospective insolvency, or the fact that the counterparty is another group member, do not make creditor expectations less legitimate. The predicament lies in legal uncertainty and increased credit risk. The main question is how to deal with such uncertainty and risk to encourage *efficient* rescue financing. We are of the opinion that the absence of ex ante authorisation might lead to foregone rescue attempts (the problem of underinvestment, see section 7.5.4.) to the detriment of estate value maximisation.

---

102 S. Madaus, On decision-making in rescue cases: why creditors and shareholders should decide about a rescue plan, in B. Santen and D. van Offeren (eds), Perspectives on international insolvency law: A tribute to Bob Wessels, Kluwer: Deventer, 2014, pp. 215-227. The decisive role of creditors in decisions concerning rescue financing is supported by Tsioli. See L. Tsioli, Rescue financing under a 'viability spotlight', Journal of Corporate Law Studies, Vol. 22, 2022, p. 876, arguing for an approach in which "terms of the rescue financing would have to be considered by the entirety of the debtor's creditors in a process that imitates the 'give-and-take' bargaining dynamics of the market-based model of rescue financing, albeit within an otherwise statutorily-organised framework."

103 R. Bork and M. Veder, Harmonisation of Transactions Avoidance Laws, 1st edn, Intersentia, 2022, paras. 4.119-4.122.

104 Ibid., para. 4.121.

Second, Bork and Veder question how any ex ante control of rescue financing is capable of incorporating the assessment of avoidance prerequisites at a later point in time.[105] Arguably, this critique may be less persuasive for interim financing, which aims to ensure the continuity of business operations during restructuring negotiations. In any event, one should weigh the anticipated benefits of rescue financing against potential detriments. The benefits have to be evaluated at the time of court authorisation, rather than when the rescue effort fails, if it does at some point in the future. Given the uncertainty of the future, establishing legal certainty via court or creditor approval may be the only means to secure rescue financing here and now.

We believe that a properly structured safe harbour for rescue financing can be a valuable tool in the group restructuring toolbox. Ex ante authorisation within a controlled and supervised process is suitable, necessary, and proportionate. The vast experience related to DIP financing in the US and a limited number of Dutch WHOA schemes support this conclusion. A statutory framework that promotes rescue financing can be particularly useful in jurisdictions without a developed rescue financing market. In these jurisdictions, the market could fail to seize the opportunity and invest in a viable business (market failure) unless it is supported by statutory intervention.

Third, the efficiency of a safe harbour regime will depend on its ability to adequately address group financial distress. Focusing solely on an individual entity within a group (e.g. an entity seeking rescue financing) is unlikely to capture the whole picture.

If reorganisation is a collaborative "group effort" and several group members are involved in securing rescue financing by acting as guarantors, co-borrowers or collateral providers, then all intra-group financial support transactions should ideally be included in a safe harbour. In the case of such an "extended" safe harbour, it is crucial to ensure that the rights and interests of creditors of the group entities involved are protected. In our view, this approach is balanced and proportionate as it: (i) fosters efficient value-preserving and value-enhancing rescue attempts, tackling underinvestment and contributing to value preservation and maximisation; (ii) ensures legal certainty and protection of trust; (iii) guarantees the finality and prevents protracted litigation, thereby facilitating procedural efficiency and cost saving; and (iv) when coupled with prior notice and a court hearing or a creditor vote on the proposed financial package, ensures procedural fairness (see section 5.2.) and offers safeguards against group opportunism, including asset stripping and gambling for resurrection.

105 Ibid., para. 4.122.

Fourth, this chapter demonstrates the challenges of balancing flexibility and legal certainty in the context of intra-group financial support within banking groups. This is an area where supranational rules (e.g. BRRD, SRMR) co-exist with national corporate, contract, and insolvency laws, but also where various political issues are at stake (home/host debate). As a result, there may be multiple obstacles and uncertainties surrounding intra-group transfers. To achieve deeper integration of the European banking sector and facilitate efficient management of resources (capital and liquidity) within banking groups, we advocate for the establishment of a bespoke, harmonised, predictable, cost-efficient and legally binding mechanism for intra-group transfers in the EU. This mechanism could draw inspiration from the existing framework for GFSAs and can bring clarity and efficiency to intra-group financing within banking groups.[106] It will reinforce trust, legal certainty, and credibility, all of which are essential for any effective cross-border resolution regime.

When it comes to non-financial enterprises, certain pre-emptive strategies common in banking groups are worth considering and learning from. These strategies include the preparation of group recovery plans, the allocation (prepositioning) of resources to key group companies and entering into group support agreements to ensure financing of these key companies in a stress situation. Pre-emptive strategies are particularly relevant and proportionate for significant non-financial enterprises (SNFEs) – companies and enterprise groups whose failure can produce significant negative social and economic externalities, affecting a large number of people and businesses, leading to increased state expenditures, bailouts, and potentially disrupting vital public services.[107] Notable examples include the bankruptcies of Chrysler and General Motors in 2009, or more recent liquidations of Carillion and British Steel. For such SNFEs, both increased state intervention and a shift from reactive, ad hoc responses to proactive measures, preparation and pre-emption are entirely justified.[108]

---

106 I. Kokorin, Preemptive Financing Arrangements within Cross-Border Banking Groups: Between Flexibility and Legal Certainty, in L. Böffel and J. Schürger (eds), Digitalisation, Sustainability, and the Banking and Capital Markets Union, Palgrave Macmillan Cham, 2022, pp. 377-395. Creation of such a legal regime is also supported by D. Ramos Muñoz, M. Lamandini, Evolving key risks in the banking sector and related priorities for the SRB: the lack of an effective transfer-based bank crisis framework, November 2022, p. 16.

107 P. van Asperen, H. Koster, Leveranciers van elektriciteit en warmte in financiële moeilijkheden: een verkenning van de wettelijke regelingen, *O&F* 2020-4, p. 70-93.

108 For a discussion on the application of bank resolution-inspired tools to significant non-financial enterprises, see I. Kokorin, Insolvency of Significant Non-Financial Enterprises: Lessons from Bank Failures and Bank Resolution, European Business Law Review, Vol. 32, 2021, pp. 521-556.

13 Limits of Freedom of Contract: Ipso Facto and Cross-default Clauses in a Group Context■

13.1 Introduction

This chapter is a logical continuation of Chapter 9, which provided a general introduction to ipso facto and cross-default clauses. To refresh the reader's memory, ipso facto clauses are provisions in contracts that entitle a party to terminate, accelerate, or amend the contract upon a certain insolvency-related event. This event may include the commencement of insolvency proceedings, the appointment of an IP, a deteriorating financial situation (existing or anticipated financial distress) of a counterparty, and even the initiation of negotiations with creditors over debt rescheduling or adjustment. In contrast, cross-default clauses – as understood in this book – are provisions that permit the termination, acceleration or amendment of a contract on the occurrence of a default on non-insolvency-related obligations, such as payment and delivery obligations or the provision of collateral. What is special about cross-default clauses is that they connect a default on one obligation to a default on another obligation, commonly under separate contracts. Ipso facto and cross-default clauses are prevalent in financial transactions, and therefore, their study falls within the scope of this book.

Chapter 9 discussed the rationale behind ipso facto and cross-default clauses and noted that they serve a risk control and risk mitigation function, allowing a counterparty to limit its exposure when dealing with a financially distressed company. In other words, they can reduce the risk of potential or foreseen non-performance by the debtor. Thus, the inclusion of ipso facto and cross-default clauses in contracts makes good commercial sense. However, their enforcement might contribute to the failure of an economically viable firm because the creditor could terminate an important contract or accelerate a large amount of debt, thereby complicating any restructuring attempt. As a result, there is a clash between party autonomy and the freedom of parties to negotiate a certain contract term, on the one hand, and the collective interest of creditors and a debtor in value preservation and maximisation. Chapter 9 showed that many legal systems resolved this conflict by prohibiting ipso facto clauses and restricting the effectiveness of cross-default clauses. This non-insignificant interference with freedom of

---

■ This chapter builds upon the following previously published work by the author:
– I. Kokorin, Promotion of group restructuring and cross-entity liability arrangements, Journal of Corporate Law Studies, Vol. 21, 2021, pp. 557-593.

contract is often explained by the policy goal of promoting restructuring or the need to protect the going concern value of the debtor's business.

There seems to be an increase in the body of rules limiting the freedom of contract in insolvency law. Leaving aside whether this trend is desirable in principle, we focus on the inter-company operation of ipso facto and cross-default clauses and the insolvency rules applicable to them. It is notable that an "event of default" causing the effects of an ipso facto clause often refers to a situation involving a company different from the company directly affected by contract termination or acceleration. This other company is sometimes referred to as a "Material Subsidiary" or a "member of the Group" (see examples in section 9.2.1.). The same is true for a cross-default clause, which could stipulate that a default by one group member triggers a default of another group member, even if the latter has not, strictly speaking, defaulted on its own obligations. We will call such clauses *cross-entity* or *intercompany* ipso facto and cross-default clauses to emphasise their group character. They increase the correlation between the fates of separate legal entities. This is especially evident against the backdrop of financial distress, when such correlation may quickly escalate into a group-wide contagion. If triggered by insolvency or a default of another group member, they may accelerate the financial distress of other group companies and even cause the fall of the entire group edifice.

The question here is whether the highlighted limitations on freedom of contract that are related to the enforceability of ipso facto and cross-default clauses, apply or should apply to cross-entity ipso facto and cross-default clauses. To answer this question, we first outline the scope of inquiry and introduce different scenarios in which a (cross-entity) ipso facto clause can be triggered (section 13.2.1.). After that, primarily relying on the textual interpretation of law, we examine whether different laws could be construed to limit the enforceability of cross-entity ipso facto clauses (sections 13.2.2.-13.2.4.). Section 13.3. explores various approaches to dealing with defaults and cross-defaults. Finally, in section 13.4., we share some thoughts on balancing of conflicting legal principles where freedom of contract and certain contract terms are at stake.

13.2 Ipso Facto Clauses in a Group Insolvency Context

13.2.1 Determining the scope of inquiry: three scenarios

According to an intercompany ipso facto clause, a filing for bankruptcy by one group entity or a similar insolvency-related event triggers a change in the rights of an affiliated legal entity -the creditor's counterparty. Consider three scenarios involving group members, Company A and Company B, and an outside Creditor.

Scenario 1. The Creditor and Company A agree that if Company A files for bankruptcy, the Creditor should be able to terminate, accelerate or amend the contract with it. In this scenario, even if there are companies belonging to Company A's corporate group (e.g. Company B), they are not affected by an ipso facto clause. The contractual provision in question is therefore not an "cross-entity" or "intercompany" ipso facto clause. As this scenario is not group-specific, it will not be further discussed.

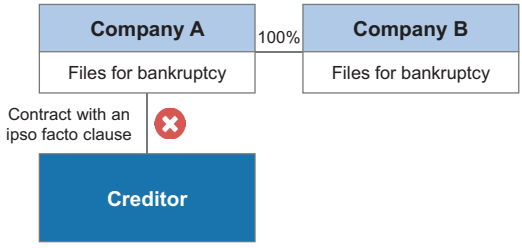

Figure 17. Scenario 1

Scenario 2. The contract between the Creditor and Company A states that if some or any of Company A's group affiliates file for bankruptcy, the Creditor can terminate, accelerate or amend the contract. We are dealing with a cross-entity ipso facto clause. Company B, Company A's affiliate (i.e. parent company), files a bankruptcy petition. Company A – the contractual counterparty of the Creditor – is solvent and duly performs the contract, while Company B is insolvent. The Creditor relies on the cross-entity ipso facto clause and terminates the contract with Company A.

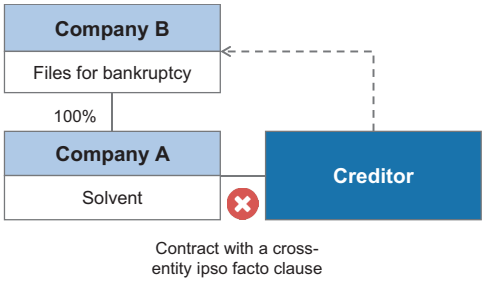

Figure 18. Scenario 2

Scenario 3. This scenario is similar to Scenario 2, except that Company A is insolvent. The Creditor relies on the cross-entity ipso facto clause and terminates the contract with Company A, arguing that such termination is solely triggered by the bankruptcy filing of Company B and not by the insolvency of Company A.

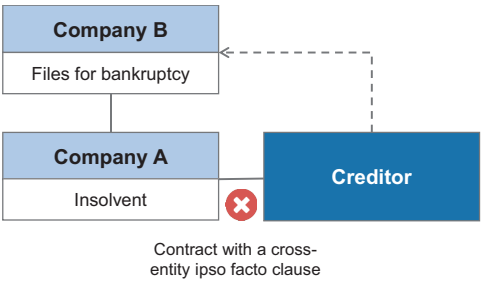

Figure 19. Scenario 3

In Scenarios 2 and 3, the termination of the contract is caused by an event that occurs within the enterprise group but is not directly attributed to the debtor's own actions or financial position. Are these scenarios covered by the limitations on ipso facto clauses? As noted below, the answer may depend on how the national law frames the limitation and how courts interpret it. The following sections explore whether national legal systems limit or could potentially limit the enforceability of intercompany ipso facto clauses. We divide these legal systems into three categories, depending on the clarity of the statutory language in terms of the potential applicability of ipso facto bans to group situations. A few caveats are, however, necessary.

First, our categorisation is primarily based on the statutory language and does not necessarily take into account its interpretation by courts. Second, it is not meant to be exhaustive or full. In addition to the jurisdictions studied in this book (i.e. the UK, the USA and the Netherlands), some other jurisdictions are included (e.g. Germany, Canada, Singapore). This is done for illustrative purposes. Third, the coverage of national laws might appear imbalanced, as more attention is paid to US law and case law when compared to UK or Dutch law. This seeming imbalance is easy to explain. The prohibition on ipso facto clauses in the USA has a much longer history (since 1978) than in the UK or the Netherlands. As a result, unlike English and Dutch courts, US courts have already dealt with cases that raise the problem of cross-entity application of the rules prohibiting ipso facto clauses. In other words, US case law exemplifies problems that perhaps have not yet arisen or been addressed by European courts.

13.2.2 The UK and the Netherlands: application to direct counterparties

The first category of jurisdictions encompasses those whose laws refer, or are most likely to refer, only to the debtor itself and to its own actions or financial position: if Company A files for bankruptcy, then the Creditor cannot terminate a contract with Company A based solely on the fact of such a filing.

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*"[1] (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"[2] (emphasis added). Germany and the Netherlands belong to this category as well. The StaRUG establishes that "notification of the restructuring case or the use of tools of the stabilisation and restructuring framework *by the debtor* is not in and of itself justification […] for terminating contracts to which *the debtor is a party* […]"[3] (emphasis added). As for Dutch law, it does not contain explicit language similar to the above provisions, simply stating that the preparation of a WHOA plan and actions related to it do not constitute grounds to terminate or amend a contract with the debtor.[4] Yet it appears from the parliamentary documents that the Dutch legislator had in mind a simple case where an entity bound by the ipso facto clause and an entity subject to a WHOA scheme are the same.[5]

In view of the relative clarity of the statutory language of countries falling in this category, extending the scope of prohibitions or limitations on ipso facto clauses to events outside the debtor's own insolvency, such as a bankruptcy filing by another group company (Scenarios 2 and 3 above), might be difficult. It would necessitate a degree of creativity in legal interpretation and adjudication, or a reliance on the vague standards of reasonableness and fairness.[6]

1 Insolvency Act 1986, sec. 233B(3).
2 Bankruptcy and Insolvency Act (R.S.C., 1985, c. B-3), sec. 65.1.
3 StaRUG, sec. 44(1).
4 Dutch Bankruptcy Act, Article 373(3).
5 MvT, *Kamerstukken II* 2018/19, 35249, 3, explaining that the party to a contract (i.e. creditor) has no legal interest to be protected via withdrawal from the contract because upon restructuring, it will have a debtor who is financially healthy again.
6 Dutch Civil Code, Article 6:248. HR 16 January 2015, *NJ* 2015/70 (*ING/De Keijzer*), noting that "termination by the lender […] is not legally valid if the use of that power is unacceptable, in view of the circumstances of the case, according to standards of reasonableness and fairness."

13.2.3 The USA: expansive interpretation of law

The second category includes countries with laws that can be interpreted to limit the effects of an ipso facto clause, even when such a clause is triggered by an insolvency-related event concerning another (non-debtor) entity. These laws can be divided into two sub-categories.

The first sub-category comprises laws which, in one way or another, state that they seek to ensure that the goal of an ipso facto ban is not undermined through attempts to bypass it. For example, the law of Singapore 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."[7] It 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"[8] (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*"[9] (emphasis added). Courts in these jurisdictions may be more willing to extend the effects of an ipso facto ban, having regard to the substance and purpose of legal provisions, and responding to the economic realities of enterprise groups.

The second sub-category covers laws that associate a prohibition of ipso facto clauses with the commencement of a relevant proceeding but do not explicitly state that this proceeding must be opened against the entity that is a party to the contract containing an ipso facto clause. Therefore, the Creditor may not be allowed to terminate a contract with Company A relying solely on the fact that Company B is subject to a bankruptcy proceeding. Based on the statutory language, we can classify France into this category as French law refers to the "commencement of a safeguard proceedings" (*l'ouverture d'une procédure de sauvegarde*).[10] Austrian law mentions the "event of the opening of insolvency proceedings" (*Fall der Eröffnung eines Insolvenzverfahrens*)[11] and therefore also falls into this sub-category.

The USA belongs to the second sub-category too. Its Bankruptcy Code makes a reference to the "commencement of *a case* under this title"[12] (emphasis added), without necessarily referring to the case against the company whose contract contains a cross-entity ipso facto clause. On its surface, the

7 IRDA, sec. 440(1).
8 IRDA, sec. 440(3).
9 Corporations Act 2001, sec. 415D(1)(f).
10 *Code de commerce*, Article L. 622-13.
11 *Insolvenzordnung* (Insolvency Act, Austria), § 25b(2).
12 11 U.S. Code § 365(e).

law is silent on the treatment of those clauses that link their consequences to bankruptcy filings by third parties. At least in one case connected to the bankruptcy of Lehman Brothers, the bankruptcy court ruled on the cross-entity operation of the ipso facto rules.[13] The case concerned the so-called "flip clause" that, upon the occurrence of a specified event of default (e.g. bankruptcy filing), flipped priority from a swap counterparty to the noteholders.[14] The Bankruptcy Court for the Southern District of New York (Judge Peck) concluded that this clause was unenforceable because it violated the ipso facto ban.[15] For purposes of this book, we do not need to discuss the complexities of the case or the validity of flip clauses under US law. Instead, what matters most are the court's findings on the cross-entity operation of ipso facto rules.

The court adopted a broad interpretation of the ipso facto ban found in § 365(e)(1). It reasoned that bankruptcy law 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). In the court's view, "the language used is not limited to the commencement of a case by or against the debtor" and that "[g]iven the legislative history, the absence of such precise limiting language is significant."[16] Notably, some of the earlier versions of § 365(e)(1) referred to "the commencement of a case under this Act *by or against the debtor*" (original emphasis). But the final version of the law is more inclusive and makes reference to "a case". As a result, the bankruptcy filing by the Lehman's corporate parent on 15 September 2008 created legal protection against ipso facto clauses with respect to its subsidiaries.

---

13 *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).

14 The validity of flip clauses under US law is a contentious issue. In some later cases, courts came to the conclusion that insolvency-triggered secured-priority flip clauses or priority shifting provisions were not prohibited ipso facto clauses. *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); *In re Lehman Brothers Holdings Inc.*, 970 F.3d 91 (2d Cir. 2020). Hence, the previous court findings concerning the legal qualification of flip clauses are no longer good law. Yet this does not necessarily mean that the court's reasoning on the inter-company application of law is invalid.

15 By contrast, English courts faced with a similar issue determined that the flip clause was valid and enforceable under English law and that it did not violate the anti-deprivation rule. *Perpetual Trustee Company Limited & another v. BNY Corporate Trustee Services Ltd & another* [2009] EWCA Civ 1160. For the analysis of complex facts and the economics of underlying transactions, read S. Worthington, Good Faith, Flawed Assets and the Emasculation of the UK Anti-Deprivation Rule, The Modern Law Review, Vol. 75, 2012, pp. 112-121; H. Collins, Flipping Wreck: *Lex Mercatoria* on the Shoals of *Ius Cogens*, in S. Grundmann, F. Möslein and K. Riesenhuber (eds), Contract Governance: Dimensions in Law and Interdisciplinary Research, OUP, 2015, pp. 383-406.

16 *In re Lehman Bros. Holdings Inc.*, 422 B.R. 407, 419 (Bankr. S.D.N.Y. 2010).

In giving this extension effect to the ipso facto ban, Judge Peck 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?"[17] The court acknowledged that expanding the scope of the ipso facto ban to cases filed by companies other than the contractual counterparty could open up a proverbial "can of worms". Yet it declined to offer any clarifications as to the necessary nature and degree of the relationship between the companies at issue, leaving this to a case-by-case determination. However, the court noted that in the Lehman Brothers group, various corporate entities comprised an integrated enterprise, where the financial state of one affiliate affected others.[18] It referred to the "Lehman corporate family" and considered that the bankruptcy filing by the corporate parent and by its affiliates constituted a "singular event for purposes of interpreting […] ipso facto language."[19]

This group-wide application of bankruptcy law was pragmatic, reflecting the purpose of prohibiting ipso facto clauses, which is the preservation of the debtor's value. In the context of a closely integrated group, the principle of estate value preservation and maximisation often requires group-mindful decisions (section 4.4.). The Lehman Brothers case best fits Scenario 3, as the entities involved therein were clearly insolvent. When it comes to Scenario 2, another case deserves attention. This case relates to the bankruptcy of Charter Communications,[20] which at the time of the Chapter 11 filing (2009), was the fourth-largest cable television provider in the USA.

Charter Communications Inc. and its affiliated companies filed Chapter 11 petitions and sought to remove more than USD 8 billion from the highly leveraged capital structure and to reinstate a senior secured credit facility pursuant to §1124(2) of the US Bankruptcy Code. We discussed this section and contract de-acceleration in section 9.4.1.2. In short, US law permits a reorganisation plan to reverse a contractual or legal acceleration and thus to reinstate a pre-default obligation, provided that all defaults have been cured, except defaults arising from an ipso-facto clause. "Ipso facto defaults" need not be cured. In fact, they cannot be cured at all since one cannot undo a bankruptcy filing.

One of the disputes concerned alleged defaults under the credit agreement. JPMorgan, acting as an agent for a syndicate of senior lenders, objected to a plan confirmation, asserting various defaults that precluded de-acceleration of the credit agreement. The said defaults were the means by which the

17 Ibid.
18 Ibid., 420.
19 Ibid.
20 *In re Charter Communications*, 419 B.R. 221, 230 (Bankr. S.D.N.Y. 2009).

lenders had hoped to improve their return by obtaining a premium over amounts payable under the existing loan documentation. The credit agreement stipulated that it shall be an event of default if the specified group entities ("Designated Holding Companies") caused any event of default that resulted in the acceleration of indebtedness. When such Designated Holding Companies filed for bankruptcy, their indebtedness could be accelerated. JPMorgan asserted that this acceleration was an event of default under the credit agreement, which allowed the irreversible acceleration of millions of dollars of debt. In a schematic way, this is what happened: the Creditor wanted to invoke the bankruptcy filing by Company B to accelerate the debt of its otherwise solvent affiliate, Company A. In turn, Company A sought to reinstate (de-accelerate) the credit agreement. Deacceleration is only possible if Company A cures all defaults, except those triggered by an ipso facto clause. It was clear to both parties that the default resulting from the bankruptcy filing of Company B could not be cured. The question was whether the default was triggered by an ipso facto clause.

Not surprisingly, JPMorgan argued that the default was not an "ipso facto default". It pointed out that (i) the clause did not speak to the borrower's (Charter Communications Operating LLC (CCO)) financial condition or bankruptcy but rather to the financial condition of affiliated, non-obligor Designated Holding Companies, and that (ii) where the debtor was solvent, the court's role was to enforce creditors' rights pursuant to contract terms.[21]

The Bankruptcy Court for the Southern District of New York ruled otherwise. Judge Peck noted that given the group integration, the event of default based on the financial condition of other group members was "necessarily connected both factually and contractually to the financial condition of CCO."[22] He observed that "concentrating attention on a single solvent entity within the corporate structure disregards relationships within the integrated corporate enterprise."[23] An event of default based on the financial condition of Designated Holding Companies was "necessarily connected both factually and contractually" to the financial condition of CCO. This is why, in the court's opinion, the clause in the credit agreement was an ipso facto clause that was ineffective and, as a consequence, the event of default created by it need not be cured for the purposes of de-acceleration and reinstatement. As a result, the lenders were bound by the original terms of the credit agreement.

---

21 Ibid., 250.

22 Ibid., 251.

23 Ibid., citing *JPMorgan Chase Bank v. Charter Communs. Operating, LLC (In re Charter Communs.)*, 409 B.R. 649, 658 (Bankr. S.D.N.Y. 2009).

The *Charter Communications* case is different from the *Lehman Brothers* case, as in the former, the entity (borrower) affected by a cross-entity ipso facto clause was admittedly solvent. Nevertheless, this did not stop the court from extending the protections of bankruptcy law to it. Still, the case was unique in several respects. First, the solvent entity that relied on the ipso facto ban filed for bankruptcy, thereby benefiting from the safeguards of bankruptcy law. As we noted before, US bankruptcy law does not require the debtor's insolvency to access Chapter 11 and benefit from its protections.[24] Second, the corporate group was integrated, so the financial condition of the group entities and their financial distress were highly correlated. The outcome of the case would likely have been different if the party to an ipso facto clause (i.e. CCO) was not in Chapter 11 or if the corporate group was decentralised and lacked economic integration.

In *Charter Communications*, the court made a commercially sensible decision. However, this decision is difficult to explain and justify from a doctrinal perspective, especially in European jurisdictions, where a bankruptcy filing typically requires some degree of financial distress. It is not easy to apply the rationale behind limitations imposed on ipso facto clauses to solvent companies. After all, it is bankruptcy law and not contract law that limits their effectiveness.[25] We will revisit this important point when presenting our suggestions.

---

24 *In re The Bible Speaks*, 65 B.R. 415, 424 (Bankr. D. Mass. 1986); *In U.S. v. Huebner*, 48 F.3d 376, 379 (9th Cir. 1994), observing that the US Bankruptcy Code "does not require any particular degree of financial distress as a condition precedent to a petition seeking relief."

25 On the point of solvency, it is important to highlight that US courts are generally willing to extend the benefits and protections of bankruptcy law to solvent group members, even if structural or contractual arrangements have been intentionally created to prevent this from happening. See *In re U.I.P. Engineered Products Corp.*, 831 F.2d 54, 56 (4th Cir. 1987), finding that "it was "clearly sound business practice for [the parent] to seek Chapter 11 protection for its wholly-owned subsidiaries when those subsidiaries were crucial to its own reorganization plan." The court observed that solvency of some debtors was not conclusive evidence of abuse of the bankruptcy process and that the nature of a corporate family created an "identity of interest" […] that justifies the protection of the subsidiaries as well as the parent corporation." *In re Gen. Growth Props.*, 409 B.R. 43, 62 (Bankr. S.D.N.Y. 2009). In this case, General Growth Properties Inc., a commercial real estate investment company, and more than 300 of its group members filed for Chapter 11, seeking to overcome the liquidity crisis and save an otherwise viable business. The interesting fact was that subsidiaries were established as special-purpose entities (SPEs), owning separate real estate properties. This SPE structure was intended to insulate the financial position of each of the subsidiaries from the problems of other group members. In other words, the group was structured to create "bankruptcy remote" entities. Nevertheless, the court denied the motions to dismiss the SPE bankruptcy cases as improper and filed in "bad faith", despite these SPEs being well-capitalised and solvent. On a point of bad faith, Judge Gropper observed that "a judgment on an issue as sensitive and fact-specific as whether to file a Chapter 11 petition can be based in good faith on consideration of the interests of the group as well as the interests of the individual debtor."

13.2.4 The BRRD and unenforceability of cross-entity ipso facto clauses

The third category comprises laws that explicitly address cross-entity ipso facto clauses. The BRRD is a good example. It recognises the group reality (see section 12.3.2.), and renders early termination, suspension, acceleration, or similar rights under a cross-entity ipso facto clause unenforceable. These rights cannot be linked to the occurrence of early intervention measures or resolution tools.[26] The goal underlying this approach is to ensure the continuity as a going concern of bank operating subsidiaries. Article 68(3) of the BRRD states that:

> Provided that the substantive obligations under the contract […] continue to be performed, a crisis prevention measure […] or a crisis management 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.[27]

To simplify, this provision can be summarised as follows: if Company B is subject to an early intervention or resolution measure, then the Creditor is not allowed to terminate a contract with Company A. The adoption of early intervention measures or resolution tools with respect to a parent entity (e.g. under a SPOE model) should therefore have no effect on the contractual rights of its subsidiaries, provided that such subsidiaries do not default on their substantive obligations. The same rule applies in the opposite direction, so that the application of resolution tools to an operating subsidiary (e.g. pursuant to a MPOE model), must not, by itself, result in the exercise of any termination, suspension, or similar rights against its parent or sister company. It is remarkable that this limitation on the freedom of contract under the BRRD is not premised on the financial condition, insolvency or financial distress, of a direct counterparty.

The BRRD deprives intercompany ipso facto clauses of their force, irrespective of the position of an entity subject to an early intervention or resolution within the banking or resolution group, or an entity in whose contract an ipso facto clause is incorporated. The BRRD gives two examples, possibly to emphasise the intercompany operation of the ipso facto rule. Yet these

---

26 For a discussion of resolution tools and their effects on contracts entered into by a failing credit institution, see F. J. Garcimartín Alférez and S. Sánchez Fernández, Resolution and contracts, in M. Haentjens, B. Wessels (eds), Research Handbook on Cross-Border Bank Resolution, Edward Elgar Publishing, 2019, pp. 201-230.

27 BRRD, Article 68(3). Crisis prevention measures include, inter alia, the exercise of powers to address or remove impediments to resolvability under Article 17 or 18 of the BRRD, as well as the application of early intervention measures under Article 27. Crisis management measures encompass resolution actions.

examples do not cover all situations in which ipso facto clauses are unenforceable (hence the use of the word "including" in Article 68(3) BRRD).

The first example concerns a situation where the contract is entered into by a subsidiary and an obligation under this contract is guaranteed or supported by another group entity. The reference to a "subsidiary" could be confusing. Does it mean that the relevant measures must be adopted with respect to a direct or indirect parent company?[28] What if these measures are imposed on a sister company or its own subsidiary?

The initial proposal for the BRRD provided for the continued enforceability of "contracts entered into by a subsidiary, the obligations under which are guaranteed or otherwise supported *by the parent undertaking*, notwithstanding any contractual right to cause the termination, liquidation or acceleration of such contracts based solely on the insolvency or financial condition of *the parent undertaking*"[29] (emphasis added). It is evident that the draft text referred to the operation of an ipso facto clause in the vertical, parent-subsidiary context. However, the final text of Article 68(3) does not mention the parent company at all, whether as an entity subject to crisis prevention or crisis management measures or as an entity guaranteeing or otherwise supporting the obligations of the subsidiary. Instead, it simply states: "supported by a group entity". Thus, the final version of the article is broader than the initial proposal. To avoid any confusion, we suggest replacing "subsidiary" with "group entity" in order to ensure that the first example cover a contract of a group entity, whose performance is guaranteed or otherwise supported by another group entity.

Regarding the requirement for an obligation to be guaranteed or otherwise supported, it indicates that the contract should implicate at least two group entities, for example, via a group guarantee. Such guarantees are typical for integrated groups. While capable of enhancing the attraction, allocation, and management of liquidity within a banking group, they also increase intra-group exposure and serve as pathways for contagion in times of crisis.[30] Against this background, the limitation of an ipso facto clause seeks to minimise or curtail group exposure. In addition to a guaranteed obligation,

28 The definition of a "subsidiary" in Article 2(5) BRRD refers to Regulation (EU) No 575/2013. The latter in Article 4(1)(16) clarifies that "[s]ubsidiaries of subsidiaries shall also be considered to be subsidiaries of the undertaking that is their original parent undertaking."

29 Proposal for a Directive establishing a framework for the recovery and resolution of credit institutions and investment firms, COM(2012) 280 final, Article 57(1)(g).

30 BCBS, Report on intra-group support measures, 2012, p. 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, 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.

the BRRD specifies that an obligation may be "otherwise supported" by a group entity. It does not offer any further clarification on the type of support meant or the corporate relationship between the entities involved. Given the broad definitions of a "group entity"[31] and "group"[32] as used in the BRRD, it appears that "support" includes both downstream (parent-subsidiary), upstream (subsidiary-parent) and cross-stream (subsidiary-subsidiary) support. As for its nature, the term "support" is wide enough to encompass different forms of intra-group financial arrangements, including co-debtorship, transfers of capital, provision of collateral and interbank lending, as long as they relate to the relevant contract.

In the second example, termination, acceleration, and similar rights cannot be exercised in relation to a contract entered into by any group member (i.e. not necessarily a subsidiary), if such a contract includes cross-default provisions. The rationale for restricting ipso facto clauses in these contracts parallels the reasoning concerning intra-group support. Its aim is to stifle contagion within a banking group, which could deter and complicate the application of early intervention measures and resolution tools. As discussed in Chapter 9, one troubling feature of cross-default clauses is their capacity to affect distinct contracts and separate entities, thereby increasing interdependence and producing a domino effect. A cross-default may "give the affiliate's counterparties the right to terminate their contracts if the holding company defaults […]."[33]

The inherent power of cross-entity ipso facto clauses to transmit risk across corporate lines has resulted in a number of initiatives to restrict their effects in global financial practice.[34] These restrictions represent a

---

31 BRRD, Article 2(1)(31).

32 BRRD, Article 2(1)(26).

33 D.A. Skeel, The new synthesis of bank regulation and bankruptcy in the Dodd-Frank era, in B.E. Adler (ed), Research Handbook on Corporate Bankruptcy Law, Edward Elgar Publishing, 2020, p. 86.

34 One such initiative is headed by the International Swaps and Derivatives Association (ISDA). ISDA developed a number of stay protocols. Under the ISDA 2014 Resolution Stay Protocol (ISDA 2014 Stay Protocol), an adhering party agrees to limit its cross-default and early termination rights to the extent that such rights are limited by the resolution or insolvency framework that governs a parent or affiliate of the counterparty with whom it has contracted. The examples of these frameworks include the US Bankruptcy Code and receivership under the Federal Deposit Insurance Act (FDIA). The ISDA 2014 Stay Protocol was replaced by the ISDA 2015 Universal Resolution Stay Protocol (ISDA 2015 Universal Protocol). However, the approach to cross-defaults has not substantially changed. The main reason for addressing default rights under the 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." S. Massman, ISDA Resolution Stay Protocol: A Brief Overview, Harvard Law School Bankruptcy Roundtable, 10 February 2015. See IMF, Law & Financial Stability, 2020, p. 36, explaining that "the protocol will help prevent the unwinding of a financial group if a global SIFI's holding company is closed by barring the termination of contracts with its subsidiaries under the commonly used "cross-default" provisions."

(semi-)contractual response to the problems explored in this chapter. For example, by agreeing to adhere to an ISDA Stay Protocol, a bank voluntarily accepts some limitations on default-triggered termination and other rights. A similar approach is followed in the USA, where the banking regulators adopted the Qualified Financial Contracts Stay Rules, aiming to facilitate the orderly reorganisation or resolution of systemically important financial institutions. Entities covered by these Rules must amend "Qualified Financial Contracts"[35] to recognise the statutory stay-and-transfer powers of the FDIC and to override any cross-default rights (in our terminology, termination rights arising from cross-entity ipso facto defaults) based on an affiliate's entry into bankruptcy or resolution proceedings.

13.3 Cross-defaults in a Group Insolvency Context

13.3.1 Suspension of default-related rights

In Chapter 9, we noted that unlike ipso facto clauses, cross-default clauses are usually held to be valid and enforceable. However, the early termination or acceleration of a contract triggered by an intercompany cross-default can lead to value destruction. In light of this, recent reforms in the UK, the Netherlands and other jurisdictions have introduced rules that impact the creditor's right to terminate or accelerate a contract based on a default (e.g. late payment), even if the contract explicitly provides for such a right. This intervention in contractual rights is motivated by the policy objective of securing business continuation and value preservation.

The CIGA and the WHOA have introduced rules stipulating that an event of default which has occurred before the commencement of an insolvency period or a cooling-off period, respectively, is not a ground to terminate the contract or withhold performance.[36] In the UK, a supplier's contractual right to terminate a contract due to any pre-insolvency event is suspended until the end of a relevant procedure (e.g. moratorium, administrative receivership, administration, CVA, liquidation, Part 26A restructuring plan, but not scheme of arrangement). In the Netherlands, termination rights are suspended for the duration of a cooling-off period granted in the WHOA procedure. In both jurisdictions, creditors cannot demand payment of all arrears as a prerequisite for continued supply.[37] The goal of both jurisdictions is to enhance opportunities for the rescue of financially distressed companies, reliant on the continuation of their agreements.

35 Dodd-Frank Act, Title II, §210(c)(8)(D). Qualified financial contracts include, inter alia, OTC and listed derivatives, swaps, commodity transactions, repos and a wide variety of securities contracts.

36 Insolvency Act 1986, section 233B(4); Dutch Bankruptcy Act, Article 373(4).

37 Insolvency Act 1986, section 233B(7); Dutch Bankruptcy Act, Article 373(4).

As for "default", Dutch law mentions "any default by the debtor" (*verzuim in de nakoming van de schuldenaar*), and English law refers to "an event occurring before the start of the insolvency period". Cross-defaults, including intercompany ones, fall within these descriptions. Hence, a creditor should not be able to rely on a cross-default clause to terminate the contract, provided that such a contract is covered by the relevant rule. As discussed in section 9.4., the suspension of termination rights in the UK does not apply to banks (whether a bank is a debtor or creditor) and to contracts involving financial services, such as lending, financial leasing and provision of guarantees. Consequently, the statutory suspension of the enforceability of (cross-)default clauses has no effect on financing agreements. A bank would be able to terminate the contract based on an intercompany cross-default. Likewise, it would be entitled to enforce a guarantee if the principal debtor defaults on its obligations, or to terminate or accelerate a loan if a group guarantor under an unrelated contract defaults, provided that the contract so allows. This may seem unfair. And yet any reference to fairness or good faith in exercising termination or acceleration rights arising from a contract term is likely to be unsuccessful. It is ultimately up to the lender to decide whether to waive a default or enforce its rights. Lenders often charge a fee for waiving an event of default.[38] This is consistent with English law's strong normative commitment to freedom of contract and concerns about ex ante effects of limiting it.

Unlike UK law, Dutch WHOA does not contain a list of contracts excluded from its scope and effects. As mentioned earlier, aside from employment contracts, the only carve-out applies to early termination and close-out netting rights in financial framework agreements (e.g. ISDA Master Agreement and GMRA). Loan agreements and corporate guarantees do not fall within these framework agreements. This is why a bank can be prevented from exercising its right to terminate or accelerate a loan if a cross-default, including a cross-entity cross-default, occurs before the cooling-off period or relates to a pre-cooling-off period obligation. For tranches advanced during the cooling-off period, the bank is entitled to request security. This somewhat counterbalances the far-reaching restrictions placed on a valid contractual right. The security requirement only applies to new obligations and does not offer the creditor any assurance that past obligations will be fulfilled.

38 L. Hornuf, M. Reps, S. Schäferling, Covenants in European investment-grade corporate bonds, Capital Markets Law Journal, Vol. 10, 2015, p. 358.

13.3.2 Neutralisation of intercompany cross-defaults in a restructuring plan

The question remains regarding the potential "survival" of an intercompany cross-default after the cooling-off period has elapsed. The Dutch Bankruptcy Act does not specifically address this issue. In the absence of a clear statutory rule that overrides an intercompany cross-default clause, one should conclude that such a clause and its effects do not cease to exist upon the expiration of a cooling-off period. If an attempt to conclude a WHOA plan fails and the debtor ends up in bankruptcy, a cross-default clause does not lose its legal force. After all, in general, bankruptcy does not change pre-bankruptcy entitlements and contractual terms. But even if a WHOA plan is confirmed, such confirmation does not automatically cure the default. The survival of cross-defaults can influence the viability of the proposed plan. This must be taken into account when assessing whether the plan's performance is adequately safeguarded and, consequently, whether the plan can be approved.[39]

To minimise risks associated with intercompany cross-defaults, the debtor could propose, during plan negotiations, that the creditor waive a cross-default. If granted, this waiver would then be based on a voluntary agreement. If the creditor votes in favour of the WHOA plan, it may be prevented from invoking a prior default. Imagine a WHOA plan, pursuant to which the creditor agrees to reschedule or postpone payments under the contract. In this case, it could be argued that the creditor has relinquished its termination rights,[40] or that termination is no longer possible according to the standards of reasonableness and fairness (Article 6:248(2) BW).[41]

If the creditor refuses to amend the contract or waive the default to neutralise the effects of a cross-default clause, the debtor has the option to initiate an early termination of the contract. This is possible under the condition

---

39 Dutch Bankruptcy Act, Article 384(2)(e). MvT, *Kamerstukken II* 2018/19, 35249, 3, p. 69. Rb. Den Haag 2 March 2021, ECLI:NL:RBDHA:2021:1798, r.o. 3.17, *JOR* 2021/102, accepting that "it is primarily up to the creditors to form an opinion about the viability of the applicant's business", but noting that this "does not alter the fact that the court may reject a request for approval of a plan if it is evidently implausible that the company is viable (after implementation of the plan)." Whether the plan's performance is adequately safeguarded is a matter of fact which must be decided by the court.

40 This conclusion can be derived from the application of the so-called Haviltex Test, which Dutch courts use when interpreting contracts. This test comes from HR 13 March 1981, *Ermes c.s./Haviltex*, *NJ* 1981/635, m.nt. C.J.H. Brunner. In this case, the Dutch Supreme Court articulated that in interpreting a contract "what matters is the sense which the parties could in the given circumstances reasonably reciprocally give to these provisions and what they could in that respect reasonably expect from each other."

41 There is a high threshold for the application of these doctrines (thus reference to "unacceptable"). H.N. Schelhaas, Redelijkheid en billijkheid (Monografieen BW), Wolters Kluwer, 2017.

that a WHOA plan has been proposed and subsequently confirmed by the court, as outlined in Article 384 Fw. The plan confirmation effectively grants consent for this unilateral termination.[42] In simpler terms, the debtor can terminate the contract subject to the suspensive condition of plan confirmation and court approval of contract termination.[43] Following the unilateral termination, the counterparty is entitled to claim compensation for any losses incurred as a result of contract termination. This claim can be restructured in the WHOA plan.[44] This legal framework shares similarities with § 365 of the US Bankruptcy Code, which was established to enable debtors to walk away from onerous contracts.[45] However, if the debtor wishes to preserve a valuable contract, amend its terms, and address any defaults – assuming the creditor does not cooperate – this "termination-oriented" framework may be of little use. Under Dutch law, the debtor cannot force the creditor to amend the contract or waive a cross-default pursuant to Article 373(1) Fw. This leaves the option to address an intercompany cross-default through a WHOA plan, wherein consensus can be replaced with coercion (cram down), if necessary.

A WHOA plan can reschedule payment obligations despite objections from creditors.[46] In this way, it can effectively cure prior defaults, including intercompany ones. The potential destabilising effect of a default can thus be addressed in the plan itself. However, the extent to which a plan can alter contract terms remains disputable. In a recent case, the court was asked to clarify whether the plan can modify the terms of a credit agreement, including those on maturity dates, interest payments, financial covenants and undertakings that, if not neutralised or cured, could lead to debt acceleration post-plan confirmation.[47] In addressing this query, the court emphasised that the WHOA was intended to be a flexible instrument. It then concluded that altering the terms of the credit agreement through the plan was both feasible and in line with the intended purpose of the law. Essentially, the court granted the debtor authorisation to rewrite the contract. The court agreed with the restructuring expert, who argued that a different conclusion would mean that any amendment to a claim could only be made through the route of Article 373(1) Fw, and therefore never without the creditor's permission. This will only lead to contract termina-

42 Articles 373(1), 383(7) Fw. Rb. Noord-Holland 19 February 2021, ECLI:NL:RBNHO:2021:1398, r.o. 3.12., *JOR* 2021/101.

43 Rb. Limburg 8 October 2021, ECLI:NL:RBLIM:2021:8851.

44 Dutch Bankruptcy Act, Article 373(2).

45 MvT, *Kamerstukken II* 2018/19, 35249, p. 10.

46 Article 370(1) Fw. MvT, *Kamerstukken II* 2018/19, 35249, 3, p. 1. N.B. Pannevis, Insolventierecht, Deventer: Wolters Kluwer, 2022, 29.4.5.1.

47 Rb. Amsterdam 5 August 2021, ECLI:NL:RBAMS:2021:6519, *JOR* 2022/102, m.nt. R. van den Sigtenhorst.

tion, making all creditor's claims immediately due and payable – not an ideal outcome if the debtor wishes to preserve the contract.[48]

In sum, Dutch law permits a WHOA scheme to re-write debtor's contracts, and in doing so to address and cure any defaults. A comparable re-writing capacity is also accessible to debtors in the USA (through a Chapter 11 reorganisation plan) and the UK (via a Part 26 scheme of arrangement, Part 26A restructuring plan, or a CVA).[49]

13.3.3 Assumption, deacceleration and substantially unrelated contracts

As highlighted in Chapter 9, the US Bankruptcy Code has specific provisions concerning executory contracts in a default scenario. It permits a trustee or a DIP, subject to court approval, to assume or reject an executory contract under certain conditions.[50] In essence, the law grants the debtor the option to pick and choose which contracts to keep, ensuring that contracts beneficial to the estate are maintained. To do so, the debtor must cure all defaults or give assurance of future performance.[51] One important exception to the assumption rule relates to a contract "to make a loan, or extend other debt financing or financial accommodations, to or for the benefit of the debtor, or to issue a security of the debtor."[52] Hence, the debtor cannot force the lender to extend new financing, even upon curing any defaults. Post-commencement financing must comply with the rules regulating DIP financing. With that in mind, there are several ways to deal with intercompany cross-defaults under US bankruptcy law.

First, group entities linked by a cross-default can simultaneously file bankruptcy petitions. This allows debtors to deal with cross-defaulted contracts via Chapter 11 plans. Commenting on the contents of reorganisation plans, Tabb observes that the "watchword in chapter 11 is flexibility. Nowhere is that more true than with regard to the contents of a plan."[53] Chapter 11 plans can effectively rewrite contracts of group members, reducing debt amounts, extending payment periods, or implementing debt-to-equity

48 Ibid., r.o. 10.15.

49 S. Paterson, A. Walters, Selective Corporate Restructuring Strategy, Modern Law Review, Vol. 86, 2023, pp. 436-464, noting that while English law does not provide an express right to a debtor to unilaterally reject a contract, it permits the modification or reduction of the debtor's obligations via a scheme, restructuring plan or CVA.

50 11 U.S. Code § 365(a).

51 11 U.S. Code § 365(b)(1).

52 11 U.S. Code § 365(c)(2).

53 C.J. Tabb, Law of Bankruptcy, 4th edn, West Academic Publishing, 2016, p. 1100.

swaps.[54] As a result, cross-defaults and intercompany cross-defaults can be resolved through reorganisation plans.[55] Of course, this does not change the requirement that a plan must comply with applicable provisions of the US Bankruptcy Code and fundamental safeguards, such as the best-interest-of-creditors test and the APR. When it comes to group restructurings, courts may pool assets and liabilities of separate entities and use a single plan for all entities, with creditors of these entities voting together and the requisite majorities being determined on a group basis.[56] This mechanism is referred to as substantive consolidation.

While courts disagree on the exact scope of this doctrine, the cases articulate a rather rigorous test, requiring either: (i) the difficulty in ascertaining separate ownership of assets among the entities, so that the costs of non-consolidating exceed the prejudice of doing so; or (ii) showing that creditors relied on the breakdown of entity boundaries and their treatment as one legal entity.[57] The mere benefit to the administration of bankruptcy estates is not a justification for substantive consolidation. In practice, some elements of substantive consolidation are present in most large Chapter 11 reorganisations. One study analysing the bankruptcy cases of public companies with USD 100 million or more in assets, filed from 2000 to 2005, concluded that approximately 56.5% involved a form of substantive consolidation, while approximately 62% of cases with debtors having USD 1 billion or more in assets were substantive consolidation cases.[58] Very few of these cases followed the rigorous standard established for substantive consolidation. Instead, they produced effects similar to those of substantive consolidation

54 Collier on Bankruptcy, 16th edn, 2022, Vol. 7, ¶ 1123.01, noting that a "plan may provide for any of the following: payment of claims in full over time; partial payment in satisfaction of claims; conversion of all or part of claims to equity; transfer of claims to a new entity; exchange of one kind of security of the debtor for another kind of security; exchange of securities of a new entity for securities of the debtor; outright cancellation of unsecured claims; cancellation of interests; and even full or partial payment of claims in kind (e.g., two pounds of chocolate for each one dollar of claims)." 11 U.S. Code § 1123.

55 *In re Mirant Corp.*, 2005 WL 6440372, at 6 (Bankr. N.D.Tex. 2005), clarifying that "[i]f the Plan is confirmed, the debt in default will be replaced by the obligations undertaken in the Plan. Thus, even if a cross-default could be asserted, confirmation of the Plan resolves and eliminates it."

56 *In re Owens Corning*, 419 F.3d 195 (3d Cir. 2005); *In re Augie/Restivo Baking Co., Ltd.*, 860 F.2d 515, 518 (2d Cir. 1988), observing that substantive consolidation "usually results in, *inter alia*, pooling the assets of, and claims against, the two entities; satisfying liabilities from the resultant common fund; eliminating inter-company claims; and combining the creditors of the two companies for purposes of voting on reorganization plans."

57 *In re Owens Corning*, 419 F.3d 195, 211 (3d Cir. 2005); *In re Archdiocese of Milwaukee*, 483 B.R. 693, 700 (Bankr. E.D. Wis. 2012); *In re Bauman*, 535 B.R. 289 (Bankr. C.D. Ill. 2015). C.J. Tabb, Law of Bankruptcy, 4th edn, West Academic Publishing, 2016, p. 233.

58 W.H. Widen, Report to the American Bankruptcy Institute: Prevalence of Substantive Consolidation in Large Public Company Bankruptcies from 2000 to 2005, American Bankruptcy Institute Law Review, Vol. 16, 2008, pp. 5-6.

via reorganisation plans and by having the requisite majorities of creditors approving such plans. These plans provided for a "deemed" substantive consolidation, typically for the purposes of voting, confirmation, and making distributions under a plan. In a "deemed" consolidation, group entities preserve their legal separateness, but the plans treat them as if the entities have been merged together.[59]

The second instance where a pre- or post-commencement default needs to be cured is the reinstatement and de-acceleration of pre-petition obligations. The debtor may want to exclude a creditor from the bankruptcy process or reinstate a below-market interest rate provided for in the existing contract with such a creditor. Either way, to do so, the relevant creditor class must be unimpaired. The class is unimpaired, if the plan: (i) leaves all creditor rights unaltered; or (ii) cures defaults, reinstates the maturity as it existed before the default, and compensates the creditor for damages suffered due to its reasonable reliance on a right to accelerate the contract.[60] To cure a default means to rectify the triggering event and restore matters to the status quo ante. A logical question arises: if a default of the debtor is caused by a default of another entity (i.e. intercompany cross default), is the debtor required to cure that "original" default before it can reinstate and de-accelerate the contract? If so, a default on a separate obligation of another group entity can place an enormous burden on the debtor who wishes to preserve the contract. The strict application of §1124(2) requires curing all defaults and cross-defaults. Yet when discussing the analogous cure provisions in the context of assumption of executory contracts (§365(b), see section 9.4.2.), we observed that courts tend to apply them in a more flexible manner and consider cross-default clauses to be "inherently suspect". Courts assess whether the enforcement of these clauses would contravene an overriding federal bankruptcy policy and impermissibly hamper the debtor's reorganisation.[61]

In some cases, courts have held that an obligation to cure defaults does not apply to cross-defaults, unless the cross-defaulted obligations are part of a single, integrated transaction, such that a breach of one contract would, independent of the cross-default provision, excuse performance under the other.[62] The necessity to cure defaults of non-debtor group entities thus

59 See *In re Chapter 11 Aventine Renewable Energy Holdings, Inc.*, 2010 Bankr. LEXIS 5160 (Bankr. D.Del. 2010); *In re Blitz U.S.A., Inc.*, 2014 Bankr. LEXIS 2461 (Bankr. D.Del. 2014); *In re Tricom, S.A.*, 2009 Bankr. LEXIS 4676 (Bankr. S.D.N.Y. 2009); *In re Republic Airways Holdings, Inc.*, 565 B.R. 710 (Bankr. S.D.N.Y. 2017).

60 11 U.S. Code § 1124(1)-(2).

61 *In re Jennifer Convertibles, Inc.*, 447 B.R. 713, 716 (Bankr. S.D.N.Y. 2011).

62 *In re Liljeberg Enterprises, Inc.*, 304 F.3d 410 (5th Cir. 2002); *In re Kopel*, 232 B.R. 57 (Bankr. E.D.N.Y. 1999); *In re Plitt Amusement Co. of Washington, Inc.*, 233 B.R. 837, 847 (Bankr. C.D. Cal. 1999), noting that cross-default provisions do not integrate otherwise separate transactions or leases.

depends on whether cross-defaulted contracts or obligations are *substantially and economically related*. The determination of "substantial relatedness" entails a fact-intense case-by-case analysis and an inquiry into whether the creditor would have been willing, absent a cross-defaulted contract, to enter into a contract that the debtor wishes to reinstate. This approach is sensible, as it aims to strike a balance between the creditor's legitimate interests and reliance on a contract term, in view of the economic interconnectedness of the linked contracts, and the debtor's interest in pursuing value-preserving reorganisation.

13.4 Conclusions and Suggestions

13.4.1 Overview of main findings

This chapter explores the interplay between contract law and insolvency law, specifically focusing on how insolvency law deals with ipso facto and cross-default clauses in a group context. In Chapter 9, we introduced these clauses and observed a gradual suppression of freedom of contract to advance insolvency law principles, such as estate value preservation and maximisation, and equal treatment of creditors. In this chapter, we discuss whether the limitations imposed on freedom of contract and the effectiveness of ipso facto and cross-default clauses apply or should apply in a group insolvency scenario. This is relevant because in many enterprise groups, financing is arranged at a group level with contract terms referring to the financial distress or default of other (non-debtor) group entities (section 9.2.).

Let us first examine cross-entity ipso facto clauses. It is clear that more and more jurisdictions are adopting rules that either ban ipso facto clauses or limit their effectiveness. However, our brief survey of laws reveals that the application of these rules in a group context is less straightforward. Among the laws we reviewed, only the BRRD expressly covers a group situation by depriving cross-entity ipso facto clauses – clauses that enable a creditor to terminate, suspend, or accelerate a contract with one group entity based on the resolution or early intervention measures applied to another group entity – of their legal force. In contrast, other laws either address a "basic" single-entity scenario and refer to the debtor, whose situation triggers an ipso facto clause (e.g. the UK, the Netherlands, Germany, Canada), or leave some room for the cross-entity application of statutory limitations on ipso facto clauses (e.g. the USA, Singapore, Austria). We attribute this omission of group considerations to the difficulty of designing a rule suitable for all groups, given the variety of their types, business models and financial structures (section 2.4.).

Insolvency law traditionally follows a single entity approach (Chapter 3). However, this single-entity-focused application of rules allows to circumvent the prohibition of ipso facto clauses. For instance, if the contract with Company A (debtor) is terminated due to the insolvency filing of its affiliate, Company B (non-debtor), one might argue that the termination is not prohibited, even if the debtor itself is insolvent. After all, it is not the debtor's insolvency that has caused the contract to be terminated, but rather the insolvency filing of another connected yet legally separate entity.[63] While technically correct, this does not change the fact that the termination of a contract might harm Company A's going concern value and survival prospects. If the creditor can evade the prohibition of ipso facto clauses by exploiting a cross-entity ipso facto clause, the effectiveness of such prohibition is undermined. The case of Companies A and B illustrates how a group environment adds complexity and highlights the problem. But it does not offer any normative guidance as to the circumstances in which the extension of insolvency law protections against ipso facto clauses to third parties, such as group members, would be desirable.

It is important to reiterate that invalidating or placing limitations on cross-entity ipso facto clauses encroaches upon freedom of contract and could undermine the legitimate expectations of the debtor's counterparties. The starting point is that a contract, or a specific contractual term, should not be disregarded without compelling reasons and merely due to insolvency. Since ipso facto clauses play a legitimate risk-mitigation and disciplining role (section 9.2.2.), their outright ban could impact the cost of finance. Therefore, any restriction on freedom of contract must be proportionate to a legitimate goal pursued. We will now shift our focus to intercompany cross-default clauses.

Intercompany cross-default clauses facilitate contagion across the corporate network. A default by one group entity on its obligation may trigger a default of another company within the same corporate group on a different obligation. The detrimental ramifications of this firm-wide ripple effect become apparent when we consider that contracts often represent some of the most valuable assets for companies. However, as we emphasised in Chapter 9, unlike ipso facto clauses, cross-default clauses are generally recognised as valid and enforceable (section 9.4.). Nevertheless, even they have not escaped the reach of insolvency laws. Different strategies are adopted by countries to respond to the disruptive effects of default-triggered rights, aiming to preserve value-generating contracts and ensure the continuity of the debtor's business. In this chapter, three such strategies were outlined,

63 A similar hypothetical case is described in A.J. Casey, The New Corporate Web: Tailored Entity Partitions and Creditors' Selective Enforcement, Yale Law Journal, Vol. 124, 2015, p. 2680.

namely: (i) suspension of termination rights; (ii) neutralisation of intercompany cross-defaults in a restructuring plan; and (iii) assumption and deacceleration of cross-defaulted contracts. These strategies do not specifically target intercompany cross-defaults but can equally apply to them.

13.4.2 Suggestions on intercompany ipso facto clauses

As previously noted, the interference in party autonomy and the freedom to agree on ipso facto clauses is explained by the intention to advance restructuring or protect the going concern value of the debtor's business. It is important to bear in mind these underlying goals when contemplating the extent to which ipso facto clauses should be limited within a group context. These goals should function as a check against undue encroachment on the freedom of contract. In pursuit of a balanced solution, the following suggestions are made.

First, the case for limiting the effectiveness of ipso facto clauses is relatively weak if the company experiencing their effects is balance sheet and cash flow solvent and remains such even after the triggering of an ipso facto clause. If a contract between Company A and the Creditor has a cross-entity ipso facto clause that grants the Creditor the right to terminate the contract upon the bankruptcy of Company B, as a general rule, the Creditor should be allowed to terminate the contract with Company A if the latter is solvent and liquid. A similar approach has been proposed in Chapter 10 (third-party releases) and Chapter 11 (extension of enforcement stays). Extending insolvency law "sweeteners" or benefits and protections that interfere with freedom of contract to solvent companies is usually problematic.

This argument is grounded in the understanding that it is the insolvency law principle of value preservation and maximisation that justifies restrictions on otherwise valid contractual rights. Westbrook writes 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."[64] This also applies to freedom of contract. Absent some form of insolvency risk, the encroachment upon the freedom of contract is difficult to substantiate. However, there could be instances where limitations on contractual rights against solvent entities can be conceived. Two of them are discussed below.

64 J.L. Westbrook, A Functional Analysis of Executory Contracts, Minnesota Law Review, Vol. 74, 1989, p. 228.

- Imagine that Company A is solvent but has a substantial financial liability triggered by a cross-entity ipso facto clause, which is activated by the insolvency filing of Company B. Despite its solvency, Company A is unable to fulfil the Creditor's accelerated claim using its current cash flows and is forced to sell its assets (e.g. production equipment) in a fire sale. These assets might be necessary for the operation of Company B, the very entity whose insolvency filing triggered the ipso facto clause. In cases like this, certain limitations on freedom of contract may be justified to preserve group synergies.
- Another scenario in which the financial condition of a counterparty can be of lesser importance concerns credit institutions, whose resolution is guided by the public interest. As observed in section 13.2.4., the BRRD deprives intercompany ipso facto clauses of their force, regardless of the financial condition of the direct counterparty, which may indeed be perfectly solvent. In the case of the BRRD, we are dealing with distinct intervening values of higher calibre. These include the maintenance of financial stability, the preservation of banks' critical functions, the protection of depositors and the avoidance of systemic risk – all of which are matters of great public interest. These considerations take precedence over the principles of freedom of contract and entity separateness. Without these values, however, one should be reluctant to intervene in contracts between solvent commercial parties.

Second, a group-level extension of insolvency law safeguards is more defendable in cases where the group is integrated and where a correlation exists between the fates and financial positions of group companies. Imagine that Companies A and B are part of one integrated enterprise. The financial distress of Company A is closely linked to the financial distress of Company B. In this case, the Creditor can rely on the bankruptcy filing or deteriorating financial condition of Company B as a mere proxy for the financial distress of its direct counterparty, Company A. In doing so, the Creditor might attempt to avoid an ipso facto ban by arguing that the clause is triggered by the bankruptcy filing of the non-debtor, Company B, while in reality, the sinking of both entities is functionally equivalent to a single enterprise filing for bankruptcy. This is what happened in the cases of *Charter Communications* and *Lehman Brothers* (section 13.2.3.). As long as ipso facto clauses are prohibited, this is troubling. It creates a loophole, allowing a creditor to rely on entity partitions to circumvent insolvency law and terminate or accelerate a contract. This is why in highly integrated groups, the extension of insolvency law protections is appropriate and gives effect to the economic reality.

Conversely, extending the effect of an ipso facto ban becomes less proportionate in the case of a decentralised group, especially when insolvency risks across group companies are not closely correlated (section 2.4.). This goes to the necessity element of the proportionality analysis. In decentral-

ised groups, the enforcement of cross-entity ipso facto clauses is less likely to result in a group-wide collapse and the destruction of group value. Instead, the emphasis shifts towards the need to safeguard creditors' legitimate expectations and their reliance on legal partitions.[65] Consequently, the balance tips in favour of protecting the freedom of contract.

Third, guided by the meta-principle of proportionality and in order to minimise any encroachment on freedom of contract, the legislator may choose to reserve the unenforceability of cross-entity ipso facto clauses to specific types of enterprises, situations or contracts. This is done in the BRRD with respect to banks, whose resolution is deemed to be in the public interest. Drawing inspiration from two examples specifically mentioned in the BRRD (see section 13.2.4.), a legislator may decide to limit the effectiveness of cross-entity ipso facto clauses in contracts guaranteed or otherwise supported by other group companies (e.g. via cross-guarantees) and in contracts containing cross-default clauses. The reason for targeting these contracts is that they increase group interdependence and are likely to instigate the spread of contagion across the entire group. They could also be perceived as creating an expectation that the transacting party is the whole group and should therefore be restructured as such. The fine-tuning of an ipso facto rule to suit specific enterprises (e.g. systemic ones), situations and contracts (e.g. contracts with cross-defaults or secured by intra-group liability) will ensure that this rule satisfies proportionality in the narrow sense.

13.4.3 Suggestions on intercompany cross-default clauses

Like ipso facto clauses, cross-default clauses are creatures of contract. As is often the case in the insolvency paradigm, freedom of contract is sidelined by insolvency law principles and collective, largely distributive interests. Two observations can be made at this point. The first observation is that legislators tend to view cross-default clauses, including intercompany ones, as less objectionable when compared to ipso facto clauses. This may explain why recent insolvency law reforms have not prohibited cross-default clauses. Instead, and this is our second observation, the effects of default-triggered clauses are tackled by different, somewhat less intrusive strategies. The suggestions below address these strategies separately.

---

65 A.J. Casey, The New Corporate Web: Tailored Entity Partitions and Creditors' Selective Enforcement, Yale Law Journal, Vol. 124, 2015, pp. 2680-2744, supporting the rule that would "prohibit the use of cross-entity ipso facto triggers as part of firm-wide enforcement but would permit them when they are part of project-specific enforcement. If the primary creditor is using cross-liability provisions in a way that pushes the entire firm into bankruptcy, then we should not allow it to turn around and pretend that it is acting against these entities individually."

First, if the law provides for a temporary suspension of default-triggered termination rights, as it does in the UK for the duration of a "relevant proceeding" and in the Netherlands for the duration of a WHOA cooling-off period, this suspension should also apply to defaults caused by an intercompany cross-default. Thus, a creditor should not be able to rely on such a default to terminate the contract during the relevant period. This approach upholds the principle of value preservation and does not contravene other principles, such as protection of creditor expectations and trust, and equal treatment of creditors.

Second, to deal with the potentially destabilising effects of intercompany cross-defaults and achieve a successful and final restructuring, a reorganisation plan should be able to amend creditors' rights and debtor's obligations, and in this way, cure and neutralise pre-filing defaults. If a default of Company A is triggered by a default of Company B, a reorganisation plan proposed in the Company A's proceeding should have the capacity to address this intercompany cross-default and ensure that it does not resurface at any point in the future, following the plan's approval. Otherwise, the finality and effectiveness of the plan will be compromised. Notably, curing the "original" default of Company B must not be a pre-condition for curing the "secondary" default of Company A through the plan. Any other approach would impose considerable constrains on the restructuring process and its ability to preserve and maximise value. At the same time, the advocated approach maintains a balance, because the creditor whose rights are modified by the plan benefits from the protections of the relevant insolvency procedure (e.g. best-interest-of-creditors test, APR, non-discrimination).

Third, when law mandates the curing of all defaults before the debtor is entitled to unilaterally assume or de-accelerate a contract, it is sensible to apply this requirement only to transactions that are substantially related or economically interdependent. This approach is generally followed by US courts, which regard cross-default clauses as "inherently suspect" and do not require the rectification of defaults in substantially unrelated obligations. Therefore, the creditor cannot impose on the debtor the costs of substantially unrelated contracts of non-debtor group entities, effectively depriving the debtor of the possibility to assume or de-accelerate a valuable contract. This approach is balanced. On the one hand, it does not affect the enforceability of intercompany cross-default clauses in situations, where doing so would undermine a creditor's bargain and legitimate expectations. The enforceability of intercompany cross-default clauses is retained when they make economic sense and form part of the bargain. On the other hand, it ensures the effectiveness of legal rules meant to contribute to estate value preservation and maximisation.

Part VI

Conclusion

14 Key Findings and Observations

14.1 Forces of Change and Group Insolvencies

Writing in 2009 on the subject of insolvencies within multinational enterprise groups, Mevorach emphasised that "thus far, legal regimes have refrained from explicitly tackling the problem [of group insolvencies]."[1] However, she pointed out that the "winds of change" were blowing – primarily referring to the work undertaken by UNCITRAL Working Group V on the topic of groups. Such winds could impact the prevailing views and approaches to handling insolvencies of corporate groups. She was right. Since 2009, various initiatives have emerged aiming to modernise insolvency law to ensure the effective and efficient administration of insolvency proceedings in the context of enterprise groups. In **Chapter 3**, this new phase was referred to as the third generation of insolvency law – insolvency law 3.0. It was preceded by two generations when there were no rules targeting group failures and cross-border insolvencies (insolvency law 1.0.), and when some rules appeared addressing international insolvencies but generally on a single-entity basis (insolvency law 2.0.).

Insolvency law 3.0. is represented by such instruments as the WHOA, StaRUG and IRDA schemes (national level), the BRRD and the EIR Recast (regional, European level), and the FSB Key Attributes and MLEGI (international level). Notably, all these instruments were adopted within the span of single decade. This represents perhaps the fastest and most spectacular progress of insolvency law in history, at least of its domain dealing with the insolvencies of enterprise groups. We believe that insolvency law 3.0. is the result of two major forces of change.

The global financial crisis and the proliferation of the so-called "rescue culture" over the past decade have facilitated the realisation and recognition that many global enterprises "live" as groups of interconnected and interdepended (yet legally separate) companies – a group reality. When these enterprises "die", the group reality should be recognised as well. Failure to do so might threaten financial stability, especially in the case of banking groups, or lead to a significant loss of value due to a breakup of important intra-group ties and the destruction of group synergies. The cases of Lehman Brothers, Nortel Networks and Oi Brazil, with which this book

1 I. Mevorach, Insolvency within Multinational Enterprise Groups, OUP, 2009, p. 326.

started, clearly illustrate this point. They uncover the complexities of resolving financial distress within the multi-layered and international structures of groups of companies.

These complexities arise, inter alia, from the ways groups arrange financing both externally and internally. Financing from third parties, such as bondholders and credit institutions, is typically accompanied by cross-guarantees, co-debtorship and collateral arrangements, as well as specific types of contractual clauses that create a correlation between entities within the group, namely intercompany ipso facto and cross-default clauses. In turn, once funds are available to a group entity, they can be transferred internally through intra-group loans and centralised cash management. While a corporate group is solvent and there is no default on obligations, these arrangements usually do not pose any problems. In contrast, in insolvency, they may result in disputes over the validity of pre-insolvency intra-group transfers (Oi Brazil), the calculation, attribution and enforcement of intercompany claims (Lehman Brothers, Nortel Networks, Oi Brazil), access to funds and valuable commercial information (Lehman Brothers), the treatment of cross-guarantees for the purposes of value allocation and distribution (Nortel Networks), and the threat of substantive consolidation which eliminates intercompany claims (Lehman Brothers, Nortel Networks, Oi Brazil). Thus, both intra-group liability arrangements and the challenges they create in a situation of financial distress and insolvency are ubiquitous.

The question of how group reality, recognised as a unique set of legal, economic, and social norms and facts, brought into the spotlight by the forces of change, can be reconciled with the treatment of group-specific financial arrangements in insolvency, is part of the puzzle that this book sought to resolve. It offers an overview and analysis of intra-group financial arrangements within the context of group insolvencies from the perspective of legal principles.

14.2 Revealing the Trunk and Branches behind the Leaves

Conducting research in the area of enterprise groups is a dangerous endeavour. The difficulty stems from the fact that enterprise groups are very different from each other. These differences concern economic, financial, operational and managerial structures. Furthermore, from a legal standpoint, there is no consistent or uniform definition of a corporate group. Such definition varies across jurisdictions and between different contexts and areas of law (section 2.3.). **Chapter 2** shows that some groups take the form of integrated pyramid-shaped enterprises with centralised management, while others lack hierarchical patterns and instead operate in a more heterarchical way, distinguished by decentralised and flatter corporate networks with largely autonomous and self-sustaining units (section 2.4.).

This diversity of corporate and operational structures, group financing, management and ownership patterns complicates or makes it impossible to develop a one-size-fits-all approach to their regulation, including regulation in a situation of financial distress and insolvency. What is appropriate for one group of companies might be inadequate, unnecessary, or even harmful to another corporate group and the creditors of its constituent members.

Given how broad-ranging groups and their financial arrangements are, this book adopts an approach that allows us to look beyond their differences and explore shared characteristics, problems and solutions – the principle-based approach. If we were to envision the subject of this book as a tree, the abundance of rules applicable to intra-group financial arrangements would symbolise the leaves on this tree.[2] When the tree is in full foliage, its leaves hide the trunk and the branches supporting them. The trunk is formed by legal principles, such as equal treatment of creditors, estate value preservation and maximisation, protection of legitimate expectations and party autonomy (**Chapter 4**). These principles are fundamental standards that underlie the rules. While the core of the legal principles is not affected in a group insolvency scenario, their application and balancing have to be re-adjusted to accommodate social, economic and legal realities (section 4.4.).

Continuing with the tree metaphor, the roots of the tree represent the meta-principles, which help to resolve conflicts between legal principles. It is often the case that several legal principles apply at the same time, either in alignment or in conflict with each other. Think of controversial ipso facto clauses. Their enforcement is supported by freedom of contract and, more generally, by party autonomy. However, such enforcement could undermine effective restructuring efforts and interfere with the preservation and maximisation of estate value – another key principle at stake. How should a judge or a legislator weigh and balance these conflicting principles? This is where the meta-principles, and in particular the meta-principle of proportionality, are of use (**Chapter 5**). In this regard, it is suggested that when legal principles collide – as they frequently do – the balancing exercise should be context- and case-specific (section 5.5.).

However, this does not mean that one cannot dissect the general or typical factors that influence the proportionality analysis. In fact, these factors can be viewed as branches of the tree, linking the legal principles (trunk) and legal rules (leaves). Discovering these branches lies at the heart of this book, as it seeks to examine when group-mindful tools or solutions are justified and how insolvency law can balance conflicting legal principles in the context of intra-group financing (section 1.2.).

---

2 An enterprise group (at least an integrated one) may itself be seen as a tree, in which leaves represent separate entities and the trunk links them all together in one common business enterprise.

14.3 Intra-group Financing and Group Insolvency: Challenges and Solutions

14.3.1 Group economic and legal realities

The main challenge in dealing with insolvencies within enterprise groups is reconciling the group economic reality with the legal reality of entity separateness. While individual members of an enterprise group are recognised in law, the group itself is not treated as a distinct legal entity. Unlike certain other areas of law (e.g. competition law), where the (economic) concept of an enterprise or undertaking transcends the boundaries of a single legal entity, insolvency law traditionally operates on an entity-by-entity basis; this is referred to as the entity bias. The division of a single enterprise into separate legal entities with their own interests, governance, pools of assets and creditors, is underpinned by the doctrines of limited liability and entity shielding. The former protects shareholders from liability for debts incurred by the legal entities they establish or invest in, while the latter ensures that the shareholder's own creditors do not have direct recourse against the assets of their companies.

Without disputing the importance of limited liability – although for highly integrated groups its rationale remains questionable – we argue that entity separateness does not and should not automatically result in complete entity insulation. Hence, it should not prevent legal responses that recognise and address group dynamics without contravening the corporate form (section 2.5.). It is observed that the more significant the implication of or incursion into limited liability and asset partitioning is, the more demanding the requirements become for the application of a specific legal tool (section 3.6.). This is why, for instance, substantive consolidation, a legal tool that leads to a complete disregard of the corporate form and eliminates intercompany claims, is typically confined to rare instances involving the intermingling of assets and liabilities within a group or cases of fraud and abuse of the corporate form.

The mismatch between group commercial and legal realities is further exacerbated by the prevalence of intra-group financial arrangements. In the legal sense, these arrangements do not undermine entity separateness. Group entities retain their independent existence and interests. In practice, however, these arrangements are often driven by the interests of the group as a whole. They promote group interdependence and weaken the protection of corporate shields, which, at least in theory, should ensure the separateness of legal entities comprising the enterprise group. Undoubtedly, intercompany liability arrangements, including cross-guarantees, co-debtorship, provision of collateral, cross-entity ipso facto and cross-default clauses serve protective, risk control and risk mitigation functions (sections 6.4., 9.2.). They could also contribute to lowering the cost of debt. Nevertheless,

in a situation of financial distress, these financial arrangements might contribute to contagion across the group (domino effect), trigger holdout behaviour of some creditors, and discourage early measures to avoid insolvency (sections 6.6., 9.5.). The conflict between a single enterprise (economic form) and a single entity (legal form) becomes especially acute.

Take, for example, cross-guarantees – one of the most pervasive elements of many financial transactions. Should these guarantees be assessed in view of the group reality, or should their benefit be calculated based solely on the position of the guarantor without regard to a broader group context? This question is discussed in **Chapter 8**. The answer to this question is of great practical relevance, as it is likely to determine whether a cross-guarantee can be avoided in insolvency. We demonstrate that under UK, US and Dutch law, group considerations can in principle be taken into account by courts. Yet the application of transaction avoidance rules to transactions involving group members and the evaluation of group interest are plagued by legal uncertainty. The problem relates to the calculation of reasonably equivalent value of a guarantee and the indirect benefits for a group guarantor, co-debtor or collateral provider (section 8.3.). We support a group-mindful application of transaction avoidance rules that take into consideration group characteristics and intra-group relations and dependencies. At the same time, it should be emphasised that group interest alone, however defined, cannot justify the deprivation or sacrifice of the rights and interests of creditors of individual group companies (section 3.5.2.).

Williamson observes that "[t]ransactions that are subject to *ex post* opportunism will benefit if appropriate safeguards can be devised *ex ante*."[3] We agree. Considering the heightened risk of group opportunism, the far-reaching effects of insolvency transaction avoidance, and the inherent legal uncertainty of ex post review of transactions, it is prudent to explore alternative strategies (**Chapter 12**). These strategies include ex ante approval or a safe harbour (section 12.2.) and pre-emptive structural and contractual support arrangements, akin to those adopted in many banking groups (section 12.3.). These strategies can be relied on to promote efficient intra-group rescue financing and mitigate the problem of underinvestment, especially if such rescue financing is exempted from statutory subordination (**Chapter 7**). They furnish a degree of legal certainty within an environment characterised by legal and economic uncertainty, while shielding existing creditors against group opportunism.

3 O.E. Williamson, Opportunism and its Critics, Managerial and Decision Economics, Vol. 14, 1993, p. 105.

14.3.2 "Extension effect" in insolvency law

The limitations of a single-entity approach and the necessity of a group-mindful approach become even more evident when group restructuring and the preservation of group synergies (group value) are at stake. Chapters 10, 11 and 13 deal with different legal tools that aim to safeguard group value and respond to the disruptive consequences of intra-group financial arrangements. What these tools have in common is that they extend the effects of insolvency law rules and protections to third (non-debtor) parties. In other words, they give an "extension effect" to insolvency law, (i) enabling the restructuring of group liabilities in a single procedure (third-party releases), (ii) providing a temporary respite from enforcement actions and allowing for a group-oriented solution (extension of a bankruptcy stay to debtor's affiliates), and (iii) advancing restructuring and protecting going concern value of the group's business by depriving certain contract clauses of their force or otherwise addressing their disruptive effects (intercompany ipso facto and cross-default clauses). These legal tools bridge economic and legal realities, preserving the separate legal identities of group entities while averting complete insulation. Nonetheless, they inevitably raise questions about compliance with legal principles such as equal treatment of creditors, protection of legitimate expectations and party autonomy. The most acute conflict is usually between the preservation and maximisation of estate value, on the one hand, and the protection of legitimate expectations and freedom of contract, on the other hand.

When a debtor files for bankruptcy, in exchange for numerous insolvency law protections, it usually undergoes a certain level of scrutiny mandated by the insolvency process. It also incurs some reputational costs. Yet third parties benefitting from the "extension effect" (non-debtor group members) may escape this scrutiny. This is why the application of legal tools with an extension effect must be carefully balanced and guided by meta-principles. The outcomes of this balancing exercise and our specific suggestions are outlined in the concluding sections of the chapters in Part V of this book: section 10.3. (third-party releases), section 11.4. (extension of an enforcement stay to group affiliates), section 13.4. (treatment of cross-entity ipso facto and cross-default clauses). Some of these suggestions are elaborated upon below.

Third-party releases. **Chapter 6** describes how the "triangle of rights and liabilities": principal debtor ⇔ guarantor ⇔ creditor, complicates restructuring efforts due to: (i) the existence of a recourse or ricochet claim (e.g. indemnity, contribution) of the paying guarantor (i.e. "ricochet problem"), or (ii) the fact that the enforcement against the guarantor could lead to its collapse, potentially undermining the effectiveness of the principal debtor's restructuring (i.e. "orphan restructuring problem"). In response, group debt deleveraging and debt adjustment can be carried out via a third-party

release. It is a practical instrument that helps to resolve some complexities of group financing and synchronise legal responses with actual business and group financing models.

Third-party releases are the subject of heated debates because they affect the rights of creditors against third (non-debtor) parties and the obligations of these parties, all without opening separate proceedings against them. This is one of the reasons why countries adopt divergent approaches to third-party releases. Whereas English courts adhere to a pro-release approach and consider third-party releases a common practice in schemes of arrangement, and while in the Netherlands third-party releases are permitted in WHOA schemes, though not necessarily outside them, the position of US courts is not uniform – they either disallow third-party releases or allow them in limited circumstances (sections 10.2.2, 10.2.3, 10.2.4).

Third-party releases are a welcome addition to the restructuring toolbox. They can safeguard the continuity of a group enterprise against destabilising effects of intercompany guarantees and other forms of cross-entity liability arrangements. The simultaneous enforcement of cross-guarantees could create additional costs and result in conflicting judgments, difficulties in implementing group-wide reorganisation, and ultimately lead to the destruction of (some) enterprise value. The case of Oi Brazil perfectly illustrates this (section 1.1.3.). While acknowledging the practical utility of third-party releases, it is emphasised that they must not strip group guarantees of their protective function. Hence, we suggest the introduction of a "group best-interest-of-creditors" test, which would ensure that a guaranteed creditor is not deprived of its baseline entitlements and the benefits afforded by a valid security arrangement and its property rights (i.e. a claim against a third party). It is also stressed that the case for a third-party release is stronger if such a release is consensual, relates to the debtor's own claim, or if the non-debtor third party is entitled to file a recourse claim against the debtor in full, potentially undermining restructuring efforts (section 10.3.2.).

Extension of enforcement stays. A less far-reaching tool addressing the "triangle of rights and liabilities" is the extension of an enforcement stay to the debtor's affiliates (**Chapter 11**). Unlike a release, a stay does not definitively adjudicate rights. Rather, it preserves a status quo and the potential for restructuring. Generally, the availability, design and scope of a stay vary significantly between different jurisdictions, and sometimes also within the same jurisdiction depending on the applicable procedure. Among the national laws studied in this book, the automatic stay under the US Bankruptcy Code stands out as the most potent, given its extremely broad scope. Dutch law provides for a stay in bankruptcy and suspension of payments procedures but does not affect the rights of secured creditors. These "separatist" creditors can enforce their security rights as if there were no bankruptcy proceedings. UK law offers a patchwork of different rules

and procedures that might be used on a stand-alone basis or in combination with other procedures (sections 11.2.1, 11.2.2., 11.2.3.). The lingering question is whether a stay can and should be extended to non-debtor group entities, acting as guarantors, co-debtors or collateral providers.

It is argued that given the group economic reality, extending the protective shield of an enforcement stay to the debtor's affiliates may be necessary to facilitate the efficient restructuring of an enterprise group. This extension aims to preserve key group synergies, maintain the operational continuity of group companies, and strengthen the debtor's bargaining power. UK law does not seem to permit such an extension. US and Dutch law, to one extent or another, grant courts the authority to extend the stay to enjoin actions against third parties (section 11.3.). However, taking into account that a stay encroaches on creditors' enforcement rights, its extension should not be automatic. Importantly, it must not unfairly prejudice the rights of affected creditors or cause substantial detriment to them. The extension of a stay to non-debtor parties should be accompanied by adequate protections to prevent potential abuse. This may require mirroring the protections inherent in the original stay and allowing for the possibility to lift the extended stay if its continuation harms the creditor. For instance, this could occur if the value of collateral provided by the third party declines or if the third party attempts to conceal assets or engages in another opportunistic behaviour (section 11.4.2).

The case for an intra-group operation of an insolvency stay appears to be stronger when the enterprise group is integrated, and a non-debtor group company plays an integral part in the debtor's restructuring, or when the restructuring involves a third-party release. In both cases, extending the stay becomes essential for the efficiency of the reorganisation. But even in cases involving asset sales, the extension of a stay might be conducive to value maximisation insofar as it preserves the group's asset pool, which is worth more than the assets of individual group companies sold separately, on an entity-by-entity basis. An illustrative case is the bankruptcy of Nortel Networks (section 1.1.2.), where the aggregate sale of assets belonging to different group companies helped to secure the highest purchase price.

Limitations on intercompany ipso facto and cross-default clauses. **Chapter 9** introduces ipso facto and cross default clauses, while **Chapter 13** focuses on their operation within the group insolvency context. Ipso facto clauses are contractual provisions that entitle the creditor to terminate, amend or accelerate the contract if certain conditions are met, including the debtor filing for bankruptcy or encountering financial distress. Cross-default clauses, on the other hand, establish that a default on one non-insolvency-related obligation (such as failure to fulfil payment obligations) triggers a default on another obligation. Both types of clauses are prevalent in financial contracts, including bond and loan documentation, as well as repurchase

and securities lending transactions. They often connect or implicate several companies within the same enterprise group, thereby increasing the correlation between separate entities and further eroding entity separateness. Particularly in times of financial distress, this correlation and interdependence can quickly escalate into a group-wide contagion.

The desire to promote restructuring and protect the going concern value of the debtor's business has prompted many countries, including the UK, the USA and the Netherlands, to interfere with parties' freedom of contract. Freedom of contract is in retreat, even in jurisdictions traditionally seen as strongholds of freedom of contract, such as the UK. This manifests in various limitations imposed on ipso facto and cross-default clauses (sections 9.3. and 9.4.). The question is whether and how these limitations apply, or should apply, to intercompany ipso facto and cross-default clauses. That is, when is it justifiable to extend insolvency law protections against certain contractual terms in a group context?

It is argued that a group-level extension of insolvency law safeguards may be warranted when the enterprise group is highly integrated, leading to a correlation between the fates and financial positions of group entities. This was, for instance, the case of the Lehman Brothers group (section 1.1.1.), in whose bankruptcy the US court granted an extension effect to the ipso facto prohibition (section 13.2.3.). Conversely, extending an ipso facto ban may be less proportionate if a group is decentralised and the insolvency risks of its entities are not correlated. To ensure a proportionate response, we suggest that the unenforceability of cross-entity ipso facto clauses is reserved for specific situations or contracts, such as those containing cross-default clauses (section 13.4.2.).

As for cross-default clauses, we make several observations. First, unlike ipso facto clauses, cross-default clauses are generally perceived to be less objectionable and thus warrant legal protection. Second, for the sake of promoting efficient restructuring and value preservation, it is asserted that a restructuring plan (e.g. a reorganisation plan under Chapter 11 or a WHOA plan) should be able to neutralise a debtor's default triggered by a default of another group entity. Third, should the law require the curing all defaults for the assumption or de-acceleration of a contract, as is typically the case under the US Bankruptcy Code, it is sensible to apply such a requirement only to substantially related or economically interdependent contracts (section 13.4.3.). This suggestion aims to strike a balance between the creditor's legitimate interests and reliance on a contract term, and the debtor's interest in pursuing effective value-preserving reorganisation.

14.4 Key Observations: Guiding Factors

14.4.1 In search for guiding factors

In her insightful book, Pistor describes how modern enterprises, such as Lehman Brothers, have turned the "legal partitioning of assets with the help of corporate law into an art form".[4] The division of a firm, representing a single interconnected economic ecosystem, into dozens, if not hundreds, of legal shells is a modern corporate reality. Be that as it may, insolvencies of giants like Lehman Brothers, Nortel Networks, Oi Brazil, and more recently of LATAM Airlines, Hertz and FTX, attest to the fact that group companies not only live together but also die (or recover) together. They show that many subsidiaries can hardly survive or raise funds without support from other group members. This support translates, inter alia, into various intra-group liability arrangements, such as intra-group guarantees and co-debtorships, which weaken or take away what is praised as the greatest privilege that shareholders enjoy – limited liability. While not all intra-group financing has a similar effect of perforating the corporate veil, they all tend to increase group interdependence and thereby diminish the persuasiveness of the entity separateness narrative.

This book explores how insolvency law can better respond to the economic realities of corporate groups and their financial arrangements. Based on this exploration, we sought to dissect a number of general considerations or factors that play a role in deciding whether a group-mindful approach should be adopted. Reprising the tree metaphor, these factors are branches hidden underneath the leaves. Without pretending to have discovered all the relevant factors, we highlight those that transpire throughout the entire book. They do not pre-determine any concrete result and should not be seen as rigid instructions. However, they could serve as key indicators, pointing in a certain direction or suggesting a decision, while leaving sufficient room for flexibility and case-specific considerations.

14.4.2 Group integration and interdependence

The first factor or theme that can guide the application of various legal tools, tackling intra-group financing, is group integration and interdependence. Such integration can be backed by a wide range of operational and financial elements. Among them are reliance on the group for business commitments (supply of essential materials, provision of licenses and know-how, leasing of premises, etc.), access to funds (e.g. intra-group loans, cross-guarantees, cash pooling), services (e.g. data management, IT, marketing), and other

4 K. Pistor, The Code of Capital: How the Law Creates Wealth and Inequality, Princeton University Press, 2019, p. 54.

forms of collaboration (information sharing, development & implementation of a business plan or strategy). Examples of highly integrated groups include Lehman Brothers, Nortel Networks, and Oi Brazil.

For fully integrated business, where group entities essentially engage in a common business and depend on each other, and where the collapse of one company is likely to lead to the failure of other group companies or of the entire group, context-specific tools and solutions tailored to the group's circumstances are justified. The factor of group integration appears in most chapters of this book, whether we are discussing transaction avoidance and the recognition of indirect benefits in intra-group financing (Chapters 8, 12), group debt deleveraging and adjustment via third-party releases addressing ricochet and orphan restructuring problems (Chapters 6, 10), the preservation of group synergies and group value through the extension of an insolvency stay to debtor's group affiliates (Chapter 11), or limitations of contract clauses, such as intercompany ipso facto and cross-default clauses (Chapters 9, 13).

The Guide to MLEGI recognises that a widely-based, possibly group-wide insolvency solution "may be of particular importance where the business of the enterprise group is conducted in a closely integrated manner."[5] The relevance of group integration should come as no surprise, as the discussed tools or solutions aim to leverage synergies across the group and connect the group (economic) reality with the legal reality of entity separateness. By contrast, what is justified and proportionate for integrated and interconnected enterprise groups may be less feasible or even disproportionate for groups of companies with a significant degree of decentralisation and independence. For these groups, where individual group companies are not dependent on each other and, as a result, the failure of one of them is unlikely to spill over to other parts of the group – in other words, where entity separateness is strong – the use of group-sensitive insolvency law tools is less necessary from the proportionality analysis (section 5.4.3.).

14.4.3 Financial situation of non-debtor group entities

The second factor relates to the financial situation of a group company seeking the benefits of extended insolvency law safeguards. If such a company is solvent and does not face cash flow or balance sheet insolvency due to a creditor action, the argument for using insolvency law "superpowers" and extending insolvency law protections, such as debt discharge and adjustment, enforcement stay, and suspension or unenforceability of ipso-facto and cross-default clauses, becomes weak.

5 Guide to MLEGI, para. 69.

After all, it is insolvency law and its principles, such as equal treatment of creditors, but most importantly, value preservation and maximisation, that serve to justify encroachment on creditors' property and contractual rights. Without insolvency risk, sustaining this justification becomes difficult, and freedom of contract, in its broadest sense, should prevail. Alongside matters of value preservation and maximisation, an insolvency process seeks to guarantee procedural and substantive fairness, underpinned by transparency, participation rights and equitable distribution of value. This is why the justification for a third-party release might be called into question when the third party benefiting from insolvency law tools does not subject itself to the requirements of an insolvency process and is not financially distressed, either before or as a result of the enforcement of a creditor's claim under a guarantee, co-debtorship, or collateral arrangement (see section 10.3.2.). Similar observations were made regarding the extension of an enforcement stay to non-debtor group entities (section 11.4.2.) and limitations on cross-entity ipso facto clauses (section 13.4.2.).

There may be cases where the enforcement of a creditor's right against a solvent group entity, acting as a group guarantor, co-obligor or collateral provider, damages or even dismantles group synergies and value, without serving a legitimate objective or the creditor's interests. In situations like this, a certain degree of flexibility could be considered. Among the jurisdictions examined in this book, the USA has the most flexible bankruptcy law. This is evidenced in the absence of any mandatory threshold of material insolvency or financial distress for accessing Chapter 11 – the principal restructuring framework. This enables the participation of different group entities, whether solvent or insolvent, in a reorganisation. The absence of an insolvency requirement, together with the affiliate-filing rule, flexible jurisdictional standards, and other important benefits offered by the US Bankruptcy Code (e.g. DIP financing regime, powerful automatic stay) have made the USA a favoured destination for restructurings of enterprise groups, including foreign ones. However, it is important to note that when group companies, whether insolvent or solvent, file for bankruptcy in US courts, they subject themselves to the obligations and requirements of the bankruptcy process, including transparency. The flexibility and lack of an insolvency threshold have also contributed to the attractiveness of English schemes of arrangement. Despite the limited toolbox of schemes compared to US Chapter 11 (e.g. no automatic stay, no cross-class cram down), they have become a popular instrument for group (financial) restructuring.

14.4.4 Purpose and nature of the procedure

The third factor refers to the purpose and nature of the procedure. Two different scenarios should be distinguished concerning the purpose. The first scenario involves (i) financial and/or operational restructurings, where

the business remains with the debtor company or a group of companies, or (ii) a going concern sale of the business to outside investors. Hence, the first scenario encompasses both "restructuring" per se, which removes debt from the business, and "asset-deal restructuring", which removes the business from its debt. The second scenario entails a piecemeal liquidation and closing down of the business. It does not matter whether such liquidation is accomplished through a Chapter 11 plan, a WHOA scheme, or any other procedure.

Third-party releases, extended enforcement stays, and restrictions on certain contract terms aim to preserve the going concern value of the debtor and of its enterprise group – value that would otherwise be lost if creditors were allowed to enforce their rights against members of the enterprise group. That being said, in the context of a piecemeal liquidation, the rationale for preserving the debtor's or the group's going concern value is less compelling. Therefore, the discussed tools become less feasible or indeed unnecessary, as they would not achieve the goals for which they were invented. However, there may be some exceptions. For example, the extension of a stay to non-debtor group companies is warranted even in a liquidation and asset sale scenario, provided that it facilitates an orderly liquidation of an enterprise group and the coordinated sale of its assets. Assets of separate group entities may be worth more if sold together. The case in point is the bankruptcy of Nortel Networks. This case demonstrates that the preservation of assets spread across different group companies, and their coordinated, global sale could secure the highest purchase price, being in full compliance with the principle of value maximisation.

When it comes to the nature of the procedure, a distinction should also be made between, on the one hand, a "light touch" or "skinny" financial restructuring,[6] which primarily targets the company's debts (rather than assets) and involves well-informed, sophisticated and strongly adjusting creditors, such as bondholders and bank lenders and, on the other hand, a full-fledged financial and operational restructuring that has an impact on the debtor's assets and affects the rights of less sophisticated parties, including employees, trade partners and tort victims. Schemes and scheme-like procedures are increasingly being employed to deleverage complex financial capital structures.[7] These procedures are correlated with additional flexibility, embraced to accommodate the realities of group financing,

6 I. Mevorach, A. Walters, The Characterization of Pre-insolvency Proceedings in Private International Law, EBOR, Vol. 21, 2020, pp. 855-894.

7 S. Paterson, Corporate Reorganization Law and Forces of Change, OUP, 2020, exploring the proliferation of a new type of corporate restructuring, one that only implicates financial liability and certain participants. This form of financial restructuring ensures the preservation of the group's cash flow, as the activities of operating companies and claims of trade creditors and employees remain unaffected by the restructuring process.

and supply legal tools to achieve group-mindful solutions. In the UK, for instance, schemes and third-party releases contained therein are often utilised to restructure group financial obligations under cross-guarantees and co-debtorship arrangements.[8] In the Netherlands, third-party releases and extended stays or cooling-off periods within WHOA schemes are directed at group financial arrangements, which frequently involve creditors who are professional financiers. Importantly, intra-group financing and the corresponding insolvency law tools rarely encroach upon the rights of vulnerable constituencies. In our view, this could justify some flexibility in the application of legal tools to implement financial restructuring and address complex financial arrangements.

Parties involved in intra-group financing tend to be better risk bearers, as they can negotiate a legal arrangement aligned with the assumed levels of risk and expected return. These parties are the ones who commonly benefit from intra-group liability arrangements, like intra-group guarantees, and have a good understanding that they are effectively transacting with the entire group. This perception is reinforced by the existence of cross-entity liability arrangements, as pointed out by US courts in the Oi Brazil case. Why is this important? When a sophisticated party engages with a group enterprise, it should be able to foresee that if the group requires deleveraging or is on the brink of failure, group-specific legal tools like third-party releases might be invoked. This has to do with the protection of legitimate expectations (section 4.4.2.). Guided by the meta-principles of fairness and proportionality, we argue that group-mindful legal tools are more defensible and justifiable in cases of financial restructuring involving group entities and sophisticated financial creditors, as opposed to non-adjusting or poorly-adjusting creditors. Perhaps this is the reason why third-party releases have recently come under fire in cases involving mass torts (e.g. Purdue Pharma) but have encountered less criticism in cases concerning the restructuring of intra-group financial obligations.

14.4.5 Prevalence of public interest

Traditionally, insolvency law has been seen as an instrument to resolve conflicts arising within a single entity, conflicts between the company and its investors – shareholders and creditors.[9] Insolvency law therefore is, for the most part: (i) microprudential: single entity-focused and designed to protect

8 The restructurings of the Dutch retailer HEMA, Switzerland-headquartered aviation services company Swissport, vending machine operator Selecta, and Spain's multinational group devoted to entertainment and leisure Codere, to name a few, have been carried out with the involvement of financial restructuring in the UK.

9 S.L. Schwarcz, Beyond Bankruptcy: Resolution as a Macroprudential Regulatory Tool, Notre Dame Law Review, Vol. 92, 2018, p. 729.

the interests of individual debtors and their creditors; (ii) contractarian: implementing the idea of the creditor's bargain and solving the coordination problem between creditors of a single entity; and (iii) reactive: centred around post-crisis asset realisation and the allocation of proceeds among creditors. The case is different for the resolution of financial institutions – a difference that became apparent in the aftermath of the Global Financial Crisis. This is when policymakers realised that a new approach is needed to prevent bank bailouts, preserve financial stability, and prevent social harm and public unrest. In this respect, Lubben contends that the primary aim of bank resolution is not adjudicatory (i.e. collective handling of claims and their enforcement), but rather regulatory.[10]

It is observed that the more prominent the role of the public interest, the greater the likelihood that law will acknowledge and give effect to a group's reality in one way or another. In economic terms, the issue at stake is the (degree of) negative externalities created by a certain behaviour. The larger these externalities, the higher the public interest concerns are, and the more likely the "groupness" is to be recognised and acted upon. This is why areas of law that tackle negative externalities and serve public interest (e.g. tax, competition and anticorruption law) tend to look beyond the fiction of entity shells.[11] Said otherwise, group-mindful solutions are powered by public interest.

The considerations of public interest underpin many post-GFC reforms in the field of bank resolution, promoting the emergence of legal tools and mechanisms at a group rather than at an individual entity level. These tools include, inter alia, group recovery and resolution plans, group financial support agreements under the BRRD, a legal regime that explicitly recognises group interest within certain boundaries (section 12.3.2.), special rules making intercompany ipso facto clauses unenforceable (section 13.2.4.), models of bank resolution, and the related requirements for pre-positioning of resources within banking groups (section 12.3.3.).

---

10 S.J. Lubben, A Functional Analysis of SIFI Insolvency, Texas Law Review, Vol. 96, 2018, p. 1396.

11 For example, EU competition law relies on the notion of an "undertaking" that covers "any entity engaged in an economic activity, irrespective of the legal status of that entity and the way in which it is financed, and thus defines an economic unit even if in law that economic unit consists of several persons, natural or legal." C-516/15, *Akzo Nobel and Others v. Commission*, 27 April 2017, para. 48. As a result, formal boundaries between the legal entities within a single economic unit and their separate legal personalities – separate in a sense of being insulated – lose their salience when dealing with conduct that constitutes an infringement of competition law. Case C-882/19, *Sumal SL v. Mercedes Benz Trucks España SL*, 6 October 2021, extending liability from a parent company to a subsidiary within the same "economic unit".

Coordinated resolution of financial distress in banking groups and financial conglomerates is logical because resolving a single company without considering its interconnectedness with other group entities and its integration in the financial system can be short-sighted and create systemic risk. Some pre-emptive strategies, including the preparation of group recovery plans, entering into group support agreements to ensure financing of key group companies in a stress situation, and their insolvency insulation through prepositioning of resources, should also be considered for non-financial enterprises (section 12.4.2.). These strategies are particularly relevant and proportionate for those among them whose insolvency poses difficult questions related to the provision of vital public services and raises employment, environmental, health and safety concerns. For such significant non-financial enterprises, there may be a role for public interest as part of the balancing between conflicting legal principles.

The enterprise group is one of the primary forms of organising economic activity. In fact, virtually every major firm is organised as a group. From early precursors of business groups, such as the Medici system of partnerships of the 15th-16th centuries and the European colonial trading empires of the 17th centuries (i.e. the Dutch and English East India Companies), to the emergence at the end of the 19th century of the first modern groups of companies characterised by multi-layered and hierarchical structures of ownership and control, groups have occupied an important place in societies' economic and political life. Yet the enterprise group is a curious case. It combines separate entities and (often) an integrated business enterprise, sometimes pierced or perforated by an elaborate network of intra-group financial arrangements and dependencies. The study of corporate groups is complicated by the diversity of their types and features, and the multiple levels of regulation (international, regional and national) that reflect the international character of most groups. It is hoped that this book will contribute to a better understanding of enterprise groups, intra-group financing, and their intersection with insolvency law.

Annex
Summary of Problems and Solutions

Transactions and contractual arrangements	Problems in insolvency	Proposed solutions
Cross-guarantees, co-debtorship, joint and several liability, and collateral arrangements (Chapter 6)	• Destruction of value as a result of simultaneous (group-wide) enforcement • Group restructuring is complicated and less efficient due to: (i) the possible existence of a recourse claim of a guarantor against the principal debtor post-restructuring ("ricochet problem"), and (ii) the failure of a group guarantor and the loss of group synergies ("orphan restructuring problem") • Misalignment of creditors' interests and the holdout position of a guaranteed creditor, resulting in the problem of the anticommons	• Third-party releases (Chapter 10) • Extension of an enforcement stay to group guarantors, co-debtors and collateral providers (Chapter 11)
	• Uncertainty and a lack of predictability in ex post review of transactions involving group members, especially with respect to the recognition of group considerations or group interest → transaction avoidance risk is not easily calculable, which contributes to legal uncertainty (Chapter 8) • Risk of transaction avoidance may discourage efficient intra-group rescue financing, e.g. in the form of a cross-guarantee to secure rescue financing from outside lenders, giving rise to the problem of under-investment	• Inclusion of group considerations in ex post review of transactions (Chapter 12) • Ex ante authorisation of transactions – a safe harbour regime, offering protection against future transaction avoidance actions (Chapter 12) • Pre-emptive support arrangements (contractual and structural) (Chapter 12)

Intra-group loans, including centralised cash management (Chapter 7)	• Risk of subordination may discourage intra-group rescue financing and lead to the problem of underinvestment • Loss of access to centrally managed cash • Risk of transaction avoidance may discourage efficient intra-group rescue financing, e.g. in the form of an intra-group loan, contributing to the problem of underinvestment (Chapter 8)	• Disapplication of subordination rules with respect to intra-group rescue financing (Chapter 12) • Inclusion of group considerations in ex post review (Chapter 12) • Ex ante authorisation of a transaction (i.e. safe harbour regime), offering protection against future transaction avoidance or permitting the continued use of a cash pool (Chapter 12) • Pre-emptive support arrangements (contractual and structural) (Chapter 12)
Intercompany ipso facto clauses (Chapter 9)	• Increased dependence and correlation between group entities • Destruction of value due to the collapse of an entire group enterprise, facilitated by the enforcement of an intercompany ipso facto clause (domino effect) • Reduced negotiation power of the debtor • Discouragement of taking early measures to address financial distress and avoid insolvency → late action reduces the chances of recovery	• Limitation of enforceability of intercompany ipso facto clauses, e.g. with respect to specific enterprises, situations and contracts (Chapter 13)
Intercompany cross-default clauses (Chapter 9)	• Increased dependence and correlation between group entities • Destruction of value due to the collapse of an entire group enterprise, facilitated by the enforcement of an intercompany cross-default clause (domino effect) • Reduced negotiation power of the debtor • Survival of cross-defaults post-restructuring	• Temporary freeze on the enforceability of intercompany cross-default clauses (Chapter 13) • Neutralisation ("curing") of intercompany cross-defaults through a restructuring plan (Chapter 13) • Contract assumption or reinstatement of a cross-defaulted contract, without the need to cure defaults in substantially unrelated (economically separate) contracts of non-debtor group entities (Chapter 13)

Bibliography

Aa M.J. van der, De afkoelingsperiode in faillissement (diss. RUG), Kluwer 2007.

Abma R., De mislukte unificatie van Unilever, Maandblad voor Ondernemingsrecht, n. 1-2, 2019, p. 40-48.

Akintola K., Creditor Treatment in Corporate Insolvency Law, Edward Elgar Publishing, 2020.

Alces P.A., The Law of Suretyship and Guarantee, Thomson Reuters, 2021.

Alexander L., Kress K., Against Legal Principles, Iowa Law Review, Vol. 82, 1997, pp. 739-786.

Alexy R., A Theory of Constitutional Rights, OUP, 2010.

Alexy R., The Construction of Constitutional Rights, Law and Ethics of Human Rights, Vol. 4, 2010, pp. 20-32.

Alexy R., On Balancing and Subsumption. A Structural Comparison, Ratio Juris, Vol. 16, 2003, pp. 433-449.

Altman J., A Test Case in International Bankruptcy Protocols: The Lehman Brothers Insolvency, San Diego International Law Journal, Vol. 12, 2011, pp. 463-496.

Altmeppen H., Das neue Recht der Gesellschafterdarlehen in der Praxis, *NJW* 2008, 3601-3607.

Andenas M., Wooldridge F., European Comparative Company Law, CUP, 2009.

Anderson G.M., McCormick R.E., Tollison R.D., The economic organisation of the English East India Company, Journal of Economic Behavior and Organization, Vol. 4, 1983, pp. 221-238.

Andrew M.T., Executory Contracts Revisited: A Reply to Professor Westbrook, University of Colorado Law Review, Vol. 62, 1991, pp. 1-36.

Andrews G., Millett R., Law of Guarantees, 7th edn, Sweet & Maxwell, 2015.

Andrews G., Millett R., Law of Guarantees, 6th edn, Sweet & Maxwell, 2011.

Andrews G., Millett R., Law of Guarantees, 4th edn, Sweet & Maxwell, 2005.

Arai-Takahashi Y., Proportionality, in D. Shelton (ed), The Oxford Handbook of International Human Rights Law, OUP, 2013.

Armour J., Transactions at an Undervalue, in J. Armour, H. Bennett (eds), Vulnerable Transactions in Corporate Insolvency, Hart Publishing, 2003, pp. 37-93.

Armour J., Hertig G., Kanda H., Transactions with creditors, in R. Kraakman et al. (eds), The Anatomy of Corporate Law: A Comparative and Functional Approach, 3rd edn, OUP, 2017, pp. 109-144.

Armour J., Menezes A., Uttamchandani M., Zwieten K. van, How do creditor rights matter for debt finance? A review of empirical evidence, in F. Dahan (ed), Research Handbook on Secured Financing of Commercial Transactions, Edward Elgar Publishing, 2015, pp. 3-25.

Armour J., Gordon J.N., Systemic Harms and Shareholder Value, Journal of Legal Analysis, Vol. 6, 2014, pp. 35-85.

Armour J., Hsu A., Walters A., The Costs and Benefits of Secured Creditor Control in Bankruptcy: Evidence from the UK, Review of Law & Economics, Vol. 8, 2012, pp. 101-135.

Asperen P. van, Koster H., Leveranciers van elektriciteit en warmte in financiële moeilijkheden: een verkenning van de wettelijke regelingen, O&F 2020-4, p. 70-93.
Avgouleas E., Goodhart C., Schoenmaker D., Bank Resolution Plans as a catalyst for global financial reform, Journal of Financial Stability, Vol. 9, 2013, pp. 210-218.
Ávila H., Certainty in Law, Springer, 2016.
Ávila H., Theory of Legal Principles, Springer, 2007.
Ayotte K., Hansmann H., Legal Entities as Transferable Bundles of Contracts, Michigan Law Review, Vol. 111, 2013, pp. 715-758.
Ayotte K.M., Morrison E.R., Creditor Control and Conflict in Chapter 11, Journal of Legal Analysis, Vol. 1, 2009, pp. 511-551.

Bae F.S.H., McGrath M.E., Rights of a Surety (or Secondary Obligor) under the Restatement of the Law, Third, Suretyship and Guaranty, Banking Law Journal, Vol. 122, 2005, pp. 783-820.
Bainbridge S.M., Henderson M.T., Limited Liability: A Legal and Economic Analysis, Edward Elgar Publishing, 2016.
Baird D.G., Priority Matters: Absolute Priority, Relative Priority, and the Costs of Bankruptcy, University of Pennsylvania Law Review, Vol. 165, 2017, pp. 785-829.
Baird D.G., Bankruptcy's Quiet Revolution, American Bankruptcy Law Journal, Vol. 91, 2017, pp. 593-622.
Baird D.G., Legal Approaches to Restricting Distributions to Shareholders: The Role of Fraudulent Transfer Law, EBOR, Vol. 7, 2006, pp. 199-215.
Baird D.G., The New Face of Chapter 11, American Bankruptcy Institute Law Review, Vol. 12, 2004, pp. 69-99.
Baird D.G., A World Without Bankruptcy, Law and Contemporary Problems, Vol. 50, 1987, pp. 173-193.
Baird D.G., Jackson T.H., Fraudulent Conveyance Law and Its Proper Domain, Vanderbilt Law Review, Vol. 38, 1985, pp. 829-855.
Baird D.G., Rasmussen R.K., Antibankruptcy, The Yale Law Journal, Vol. 119, 2010, pp. 648-599.
Baird D.G., Rasmussen R.K., The End of Bankruptcy, Stanford Law Review, Vol. 55, 2002, pp. 751-789.
Bar C. von, et al. (eds), Principles, Definitions and Model Rules of European Private Law. Draft Common Frame of Reference (DCFR), Outline Edition, Sellier, 2009.
Barak A., Proportional Effect: The Israeli Experience, University of Toronto Law Journal, Vol. 57, 2007, pp. 369-382.
Barak A., The Judge in a Democracy, Princeton University Press, 2006.
Barneveld J., Financiering en vermogensonttrekking door aandeelhouders, Serie vanwege het Van der Heijden Instituut, vol. 120, Deventer: Kluwer, 2014.
Barneveld J., Corpeleijn F., Financiering met risicomijdend vermogen? Over de aandeelhouderslening in faillissement, TvI 2014/39.
Bartman S., Dutch Supreme Court at a Loss over Groups, European Company Law, Vol. 13, 2016, pp. 123-128.
Bartman S., Dorresteijn A., Olaerts M., Van het Concern, Wolters Kluwer, 2020.
Baudino P., Sturluson J.T, Svoronos J-P., The Banking Crisis in Iceland, FSI Crisis Management Series No. 1, March 2020.
Beatty D.M., The Ultimate Rule of Law, OUP, 2004.
Bebchuk L.A., Fried J.M., The Uneasy Case for the Priority of Secured Claims in Bankruptcy, The Yale Law Journal, Vol. 105, 1996, pp. 857-934.

Becht M., Mayer C., Wagner H., Where do Firms Incorporate? Deregulation and the Cost of Entry, Journal of Corporate Finance, Vol. 14, 2008, pp. 241-256.
Behme C., InsO § 39 Nachrangige Insolvenzgläubiger, Münchener Kommentar zur Insolvenzordnung, 4. Auflage 2019.
Bennett H., Late Floating Charges, in J. Armour, H. Bennett (eds), Vulnerable Transactions in Corporate Insolvency, Hart Publishing, 2003, pp. 183-215.
Bergervoet G.J.L., Borgtocht (Onderneming en recht nr. 84), Deventer: Kluwer, 2014.
Bergström C., Eisenberg T., Sundgren S., Secured Debt and the Likelihood of Reorganization, International Review of Law and Economics, Vol. 21, 2002, pp. 359-372.
Berle A.A. Jr., The Theory of Enterprise Entity, Columbia Law Review, Vol. 47, 1947, pp. 343-358.
Beyhaghi M., Third-Party Credit Guarantees and the Cost of Debt: Evidence from Corporate Loans, Review of Finance, Vol. 26, 2022, pp. 287-317.
Binder J-H., Resolution Planning and Structural Bank Reform within the Banking Union, SAFE Working Paper No. 81, 2014, pp. 1-33.
Block-Lieb S., Fishing in Muddy Waters: Clarifying the Common Pool Analogy as Applied to the Standard for Commencement of a Bankruptcy Case, American University Law Review, Vol. 42, 1993, pp. 337-431.
Blumberg P. et al., Blumberg on Corporate Groups, 2nd edn, Wolters Kluwer, 2021.
Blumberg P., The Transformation of Modern Corporation Law: The Law of Corporate Groups, Connecticut Law Review, Vol. 37, 2005, pp. 605-617.
Blumberg P., The Corporate Entity in an Era of Multinational Corporations, Delaware Journal of Corporate Law, Vol. 15, 1990, pp. 283-375.
Blumberg P., Intragroup (Upstream, Cross-Stream, and Downstream) Guarantees under the Uniform Fraudulent Transfer Act, Cardozo Law Review, Vol. 9, 1987, pp. 685-728.
Blumberg P., Limited Liability and Corporate Groups, The Journal of Corporation Law, Vol. 11, 1986, pp. 573-631.
Bolton P., Oehmke M., Bank Resolution and the Structure of Global Banks, The Review of Financial Studies, Vol. 32, 2019, pp. 2384-2421.
Boom W.H. van, Hoofdelijke verbintenissen, Den Haag: Boom Juridische uitgevers, 2016.
Boom W.H. van, Het ontstaansmoment en de verjaring van de regresvordering, Ars Aequi, Januari 2013, p. 36-43.
Boom W.H. van, Hoofdelijke verbintenissen, W.E.J. Tjeenk Willink, 1999.
Boon G-J., Vriesendorp R.D., Koster H., The WHOA: the Breakthrough for a Dutch Business Rescue Culture, HERO 2022 / W-008, 15 December 2022.
Bork R., Corporate Insolvency Law. A Comparative Textbook, Intersentia, 2020.
Bork R., Principles of Cross-Border Insolvency Law, Intersentia, 2017.
Bork R., Transactions at an Undervalue – A Comparison of English and German Law, Journal of Corporate Law Studies, Vol. 14, 2014, pp. 453-477.
Bork R., Rescuing Companies in England and Germany, OUP, 2012.
Bork R., Veder M., Harmonisation of Transactions Avoidance Laws, Intersentia, 2022.
Bork R., Zwieten K. van (eds), Commentary on the European insolvency regulation, OUP, 2016.
Bork R., Abschaffung des Eigenkapitalersatzrechts zugunsten des Insolvenzrechts? ZGR 2007, 250-270.
Bourbouloux H., Hustaix S., National Report on France, in B. Wessels and S. Madaus (eds), Rescue of Business in Europe: A European Law Institute Instrument, OUP, 2020, pp. 624-678.

Bovenzi J.F., Guynn R.D., Jackson T.H., Too Big to Fail: The Path to a Solution, Economic Policy Program Financial Regulatory Reform Initiative, May 2013.
Boyle P.M., Non-Debtor Liability In Chapter 11: Validity of Third-Party Discharge In Bankruptcy, Fordham Law Review, Vol. 61, 1992, pp. 421-450.
Bridge M.G., The Exercise of Contractual Discretion, Law Quarterly Review, Vol. 135, 2019, pp. 227-248.
Bricongne J-C., Demertzis M., Pontuch P., Turrini A., Macroeconomic Relevance of Insolvency Frameworks in a High-debt Context: An EU Perspective, European Commission Discussion Paper 32, June 2016.
Brosnan S.F., Waal F.B.M. de, Evolution of responses to (un)fairness, Science, Vol. 346, 2014, pp. 314-321.
Brubaker R., Mandatory Aggregation of Mass Tort Litigation in Bankruptcy, The Yale Law Journal Forum, 28 February 2022, pp. 960-1009.
Brubaker R., Bankruptcy Injunctions and Complex Litigation: A Critical Reappraisal of Non-Debtor Releases in Chapter 11 Reorganizations, University of Illinois Law Review, Vol. 1997, 1997, pp. 959-1080.
Bufford S.L., Coordination of Insolvency Cases for International Enterprise Groups: A Proposal, American Bankruptcy Law Journal, Vol. 86, 2012, pp. 685-748.
Burg E., The Model of Principles. The quest for rationality in the implementation of conflicting principles, Universiteit van Amsterdam, Faculteit der Rechtsgeleerdheid, 2000.
Burrows A., Remedies for Torts, Breach of Contract, and Equitable Wrongs, OUP, 4th edn, 2019.
Burrows A. (ed), Principles of English Commercial Law, OUP, 2015.
Burrows A., English Private Law, 3rd edn, OUP, 2013.

Cahn A., Equitable Subordination of Shareholder Loans? EBOR, Vol. 7, 2006, pp. 287-300.
Cahn A., Donald D.C., Comparative Company Law: Text and Cases on the Laws Governing Corporations in Germany, the UK and the USA, 2nd edn, CUP, 2018.
Campbell A., Moffatt P., Large scale bank insolvencies and the challenges ahead, in M. Haentjens and B. Wessels (eds), Research Handbook on Crisis Management in the Banking Sector, Edward Elgar Publishing, 2015, pp. 55-78.
Carlos A.M., Nicholas S., "Giants of an Earlier Capitalism": The Chartered Trading Companies as Modern Multinationals, The Business History Review, Vol. 62, 1988, pp. 398-419.
Carmassi J., Herring R.J., Corporate Complexity and Systemic Risk: A Progress Report, in A.N. Berger, P. Molyneux and J.O.S. Wilson (eds), The Oxford Handbook of Banking, OUP, 3rd edn, 2019, pp. 95-130.
Carmassi J., Herring R.J., The Corporate Complexity of Global Systemically Important Banks, Journal of Financial Services Research, Vol. 49, 2016, pp. 175-201.
Carrizosa R., Ryan S., Borrower private information covenants and loan contract monitoring, Journal of Accounting and Economics, Vol. 64, 2017, pp. 313-339.
Casey A.J., The New Corporate Web: Tailored Entity Partitions and Creditors' Selective Enforcement, The Yale Law Journal, Vol. 124, 2015, pp. 2680-2744.
Casey A.J., Macey J., In Defense of Chapter 11 for Mass Torts, The University of Chicago Law Review, Vol. 90:3, 2023, pp. 973-1021.
Castermans A.G., Krans H.B., commentaar op art. 7:866 BW, in: H.B. Krans, C.J.J.M. Stolker en W.L. Valk (red.), Tekst & Commentaar Burgerlijk Wetboek, Deventer: Wolters Kluwer (online).

Cerutti E., Ilyina A., Makarova Y., Schmieder C., Bankers Without Borders? Implications of Ring-Fencing for European Cross-Border Banks, in L.L. Ong (ed), A Guide to IMF Stress Testing: Methods and Models, 2014, pp. 151-164.

Chandler A.D., Scale and Scope: The Dynamics of Industrial Capitalism, HUP, 1994.

Che Y-K., Schwartz A., Section 365, Mandatory Bankruptcy Rules and Inefficient Continuance, Journal of Law, Economics, & Organization, Vol. 15, 1999, pp. 441-467.

Clark K., Taylor A., Events of Default in Eurocurrency Loan Agreements, International Financial Law Review, Vol. 1, 1982, pp. 12-15.

Clark R.C., The Duties of the Corporate Debtor to its Creditors, Harvard Law Review, Vol. 90, 1977, pp. 505-562.

Coates J.C. IV, The Volcker Rule as structural law: implications for cost-benefit analysis and administrative law, Capital Markets Law Journal, Vol. 10, 2015, pp. 447-468.

Coco D., Third-Party Bankruptcy Releases: An Analysis of Consent Through the Lenses of Due Process and Contract Law, Fordham Law Review, Vol. 88, 2019, pp. 231-265.

Coles-Bjerre A., Ipso Facto: The Pattern of Assumable Contracts in Bankruptcy, New Mexico Law Review, Vol. 40, 2010, pp. 77-122.

Collins H., Flipping Wreck: *Lex Mercatoria* on the Shoals of *Ius Cogens*, in S. Grundmann, F. Möslein and K. Riesenhuber (eds), Contract Governance: Dimensions in Law and Interdisciplinary Research, OUP, 2015, pp. 383-406.

Colpan A.M., Hikino T. (eds), Business Groups in the West: Origins, Evolution, and Resilience, OUP, 2018.

Conac P-H., Director's duties in groups of companies – legalizing the interest of the group at the European level, European Company and Financial Law Review, Vol. 10, 2013, pp. 194-226.

Cook W., Watered Stock Commissions Blue Sky Laws Stock without Par Value, Michigan Law Review, Vol. 19, 1921, pp. 583-598.

Cooper N.H., Insolvency proceedings in case of groups of companies: prospects of harmonisation at EU level, Briefing Note, 2011.

Cooper R.J., Cestero F.L., Mosier J.W., Oi S.A.: The Saga of Latin America's Largest Private Sector In-court Restructuring, Pratt's Journal of Bankruptcy Law, Vol. 14, 2018, pp. 209-221.

Cooper R.J., Cestero F.L., Mosier J.W., Soltman D.J., The Brazilian Insolvency Regime: Some Modest Suggestions – Part II, Pratt's Journal of Bankruptcy Law, Vol. 12, 2016, pp. 160-168.

Corapi D., Benincasa D., The Law on Groups of Companies in Italy, European Company Law, Vol. 16, 2019, pp. 121-129.

Countryman V., Executory Contracts in Bankruptcy: Part II, Minnesota Law Review, Vol. 58, 1974, pp. 479-567.

Countryman V., Executory Contracts in Bankruptcy: Part I, Minnesota Law Review, Vol. 57, 1973, pp. 439-491.

Couwenberg O., Lubben S.J., Essential Corporate Bankruptcy Law, EBOR, Vol. 16, 2015, pp. 39-61.

Craig R., Groups of companies: the parent subsidiary relationship and creditors remedies, PhD thesis, University of Durham, 1999.

Crystal M., Mokal R.J., The Valuation of Distressed Companies – a Conceptual Framework, International Corporate Rescue, Issues 2 and 3, 2006.

Cukierman A., Central Bank Strategy, Credibility, and Independence: Theory and Evidence, MIT Press, 1992.

Cumming C., Eisenbeis R.A., Resolving Troubled Systemically Important Cross-Border Financial Institutions: Is a New Corporate Organizational Form Required? Federal Reserve Bank of New York, Staff Report No. 457, 2010.

Dahiya S. et al., Debtor-in-possession financing and bankruptcy resolution: Empirical evidence, Journal of Financial Economics, Vol. 69, 2003, pp. 259-280.

Dammann J., Related Party Transactions and Intragroup Transactions, in L. Enriques and T.H. Tröger (eds), The Law and Finance of Related Party Transactions, CUP, 2019, pp. 218-244.

Dammann R., Lessons to be learned from the Nortel case, Eurofenix, No. 82, Winter 2020/21, pp. 34-35.

Dari-Mattiacci G., Gelderblom O., Jonker J., Perotti E.C., The Emergence of the Corporate Form, The Journal of Law, Economics, and Organization, Vol. 33, 2017, pp. 193-236.

Dau L.A., Morck R., Yeung B.Y., Business groups and the study of international business: A Coasean synthesis and extension, Journal of International Business Studies, Vol. 52, 2021, 161-211.

Davies P., Introduction to Company Law, 3rd edn, OUP, 2020.

Davies P., Resolution of cross-border groups, in M. Haentjens and B. Wessels (eds), Research Handbook on Crisis Management in the Banking Sector, Edward Elgar Publishing, 2015, pp. 261-282.

Davies P., Directors' Creditor-Regarding Duties in Respect of Trading Decisions Taken in the Vicinity of Insolvency, EBOR, Vol. 7, 2006, pp. 301-337.

Davies P.S., Raczynska M. (eds), Contents of Commercial Contracts: Terms Affecting Freedoms, Hart Publishing, 2020.

Declercq P.J.M., The actions of a distressed investor in the restructuring of Brazilian Telecom Group Oi SA assessed – villain or essential contributor to the development of law & practice in cross-border restructurings/insolvencies of groups? INSOL World, Second Quarter 2018, pp. 12-14.

Deslandes J., Magnus M., Further Harmonising EU Insolvency Law from a Banking Resolution Perspective? April 2018.

Dewatripont M., Montigny M., Nguyen G., When trust is not enough: Bank resolution, SPE, Ring-fencing and group support, ECGI Finance Working Paper No. 759/2021, May 2021.

Dhillon U.S., Noe T., Ramírez G.G., Debtor-in-possession financing and the resolution of uncertainty in Chapter 11 reorganisations, Journal of Financial Stability, Vol. 3, 2007, pp. 238-260.

Di Gennaro M.J., Goldstein H.J., Can Ipso Facto Clauses Resolve the Discharge Debate? An Economic Approach to Novated Fraud Debt in Bankruptcy, DePaul Business and Commercial Law Journal, Vol. 1, 2003, pp. 417-447.

Dijck G. van, De Faillissementspauliana: Revisie van een Relict (proefschrift), Wolf Legal Publishers, 2016.

Dolan J.F., Standby Letters of Credit and Fraud (Is the Standby Only Another Invention of the Goldsmiths in Lombard Street?), Cardozo Law Review, Vol. 7, 1985, pp. 1-45.

Dooren E.A. van, De aansprakelijkheid op grond van een 403-verklaring (diss.), Uitgaven vanwege het instituut voor Ondernemingsrecht nr. 122, Deventer: Wolters Kluwer, 2021.

Downs W., A Surety's Basic Rights and Remedies, Defense Lawyers Journal, Vol. 15, 1966, pp. 165-176.

Doyle J.G., Insolvency Litigation, Sweet & Maxwell, 1999.

Drescher F., Insolvency Timing and Managerial Decision-Making, Springer Gabler, 2014.
Drooghenbroeck S. Van, Rizcallah C., The ECHR and the Essence of Fundamental Rights: Searching for Sugar in Hot Milk? German Law Journal, Vol. 20, 2019, p. 904-923.
Duggan A., Ben-Ishai S., Sarra J., Telfer T., Wood R., Canadian Bankruptcy and Insolvency Law: Cases, Text, and Materials, 3rd edn, Emond Montgomery Publications, 2015.
Dworkin R., Is Democracy Possible Here? Principles for a New Political Debate, Princeton University Press, 2006.
Dworkin R., Taking Rights Seriously, HUP, 1977.
Dworkin R., The Model of Rules, The University of Chicago Law Review, Vol. 35, 1967, pp. 14-46.

Easterbrook F.H., Fischel D.R., Limited Liability and the Corporation, University of Chicago Law Review, Vol. 52, 1985, pp. 89-117.
Ehmke D., Publicly Offered Debt in the Shadow of Insolvency, EBOR, Vol. 16, 2015, pp. 63-96.
Ehmke D.C., Gant J.L.L., Boon G-J., Langkjaer L., Ghio E., The European Union preventive restructuring framework: A hole in one? International Insolvency Review, Vol. 28, 2019, pp. 184-209.
Eidenmüller H., Comparative Corporate Insolvency Law, in J.N. Gordon, W-G. Ringe (eds), The Oxford Handbook of Corporate Law and Governance, OUP, 2018, pp. 1003-1036.
Eidenmüller H., Contracting for a European Insolvency Regime, EBOR, Vol. 18, 2017, pp. 273-304.
Eidenmüller H., What is an insolvency proceeding? ECGI Law Working Paper No. 335/2016, December 2016.
Eidenmüller H., Trading in Times of Crisis: Formal Insolvency Proceedings, Workouts, EBOR, Vol. 7, 2006, pp. 239-258.
Eisdorfer A., Empirical Evidence of Risk Shifting in Financially Distressed Firms, The Journal of Finance, Vol. 63, 2008, pp. 609-637.
Eisenberg T. (ed), Debtor-Creditor Law, Matthew Bender & Company, Inc., 2022.
Enriques L., Gilotta S., The Case Against a Special Regime for Intragroup Transactions, ECGI Law Working Paper No. 641/2022, May 2022.
Enriques L., Related Party Transactions, in J.N. Gordon and W-G. Ringe (eds), The Oxford Handbook of Corporate Law and Governance, OUP, 2018, pp. 506-531.
Enriques L., The Mandatory Bid Rule in the Takeover Directive: Harmonization Without Foundation? European Company and Financial Law Review, Vol. 1, 2004, pp. 440-457.
Enriques L., Gelter M., How the Old World Encountered the New One: Regulatory Competition and Cooperation in European Corporate and Bankruptcy Law, Tulane Law Review, Vol. 81, 2007, pp. 577-646.
Epstein R.A., Contracts Small and Contracts Large: Contract Law through the Lens of Laissez-Faire, in F.H. Buckley (ed), The Fall and Rise of Freedom of Contract, Duke University Press, 1999, pp. 25-61.
Erikson E., Between Monopoly and Free Trade: The English East India Company, Princeton University Press, 2014.
Etkin M.S., Brown N.M., Third-Party Release? – Not So Fast! Changing Trends and Heightened Scrutiny, AIRA Journal, Vol. 29, 2015, pp. 22-29.

Faber D., Vermunt N., National Report for the Netherlands, in D. Faber, N. Vermunt, J. Kilborn, K. van der Linde (eds), Treatment of Contracts in Insolvency, OUP, 2013, pp. 287-330.
Fedke T., Konzerninnenfinanzierung nach dem MoMiG in insolvenznahen Szenarien, *NZG* 2009, 928-932.
Feltz G.F. van der, Geschiedenis van de Wet op het Faillissement en de Surséance van Betaling, Haarlem: De Erven F. Bohn 1896.
Ferran E., Ho L.C., Principles of Corporate Finance Law, 2nd edn, OUP, 2014.
Finch V., Corporate Insolvency Law: Perspective and Principles, CUP, 2002.
Finch V., Milman D., Corporate Insolvency Law: Perspectives and Principles, 3rd edn, CUP, 2017.
Fleming M.J., Sarkar A., The Failure Resolution of Lehman Brothers, Federal Reserve Bank of New York Economic Policy Review, Vol. 20, 2014, pp. 175-206.
Fletcher I., The Law of Insolvency, 5th edn, Sweet & Maxwell, 2017.
Fontán I.A. et al., Banking Supervision and Resolution in the EU: Effects on Small Host Countries in Central, Eastern and South Eastern Europe, World Bank Group Working Paper, April 2019.
Franken M.J.M., Verificatie van vorderingen, redelijkheid en billijkheid tussen schuldeisers onderling: een gemiste kans?, in: N.E.D. Faber et al., De bewindvoerder, een octopus, Serie Onderneming en Recht deel 44, Deventer: Kluwer 2008.
Freedland F., History of Holding Company Legislation in New York State: Some Doubts as to the "New Jersey First" Tradition, Fordham Law Review, Vol. 24, 1955, pp. 369-411.
Frentrop P., The Dutch East India Company: the first corporate governance debacle, in T. Clarke, J. O'Brien and C.R.T. O'Kelley (eds), The Oxford Handbook of the Corporation, OUP, 2019, pp. 51-74.
Friedman M., Capitalism and Freedom, The University of Chicago Press, 2020 (originally published in 1962).
Frisby S., Of rights and rescue: a curious confluence? Journal of Corporate Law Studies, Vol. 20, 2020, pp. 39-72.

Galen R.J. van, De surseance als echte reorganisatieprocedure, TvI 2015/23.
Galen R. van, Insolvent Groups of Companies in Cross Border Cases and Rescue Plans, Report to the Netherlands Association for Comparative and International Insolvency Law (8 November 2012).
Gant J.L.L., Balancing the Protection of Business and Employment in Insolvency: An Anglo-French Perspective, Eleven International Publishing, 2017.
Gant J.L.L., Studies of Convergence? Post-Crisis Effects on Corporate Rescue and the Influence of Social Policy: the EU and the USA, International Insolvency Review, Vol. 25, 2016, pp. 72-96.
Garcimartín Alférez F. J., Sánchez Fernández S., Resolution and contracts, in M. Haentjens, B. Wessels (eds), Research Handbook on Cross-Border Bank Resolution, Edward Elgar Publishing, 2019, pp. 201-230.
Gardella A., Rimarchi M., Stroppa D., Potential regulatory obstacles to cross-border mergers and acquisitions in the EU banking sector, EBA Staff Paper Series No. 7, 2020, pp. 1-75.
Garcimartín F., Bermejo N., Involving secured creditors in restructuring proceedings, in P.J. Omar and J.L.L. Gant (eds), Research Handbook on Corporate Restructuring, Edward Elgar Publishing, 2021, pp. 120-142.
Garner B.A. (ed), Black's Law Dictionary, 8th edn, Thomson West, 2004.

Gelderblom O., Jong A. de, Jonker J., The Formative Years of the Modern Corporation: The Dutch East India Company VOC, 1602-1623, The Journal of Economic History, Vol. 73, 2013, pp. 1050-1076.

Gelter M., The subordination of shareholder loans in bankruptcy, International Review of Law and Economics, Vol. 26, 2006, pp. 478-502.

Gerner-Beuerle C., Schillig M., Comparative Company Law, OUP, 2019.

Ghio E., Transposing the preventive restructuring directive 2019 into French insolvency law: Rethinking the role of the judge and rebalancing creditors, International Insolvency Review, Vol. 30, 2021, pp. 54-74.

Gilje E., Do Firms Engage in Risk-Shifting? Empirical Evidence, The Review of Financial Studies, Vol. 29, 2016, pp. 2925-2954.

Goehausen H.A., You Said You Were Going to Do What to My Loan? The Inequitable Doctrine of Recharacterization, DePaul Business and Commercial Law Journal, Vol. 4, 2005, pp. 117-142.

Goey F. De, Jong A. De, The Netherlands: The Overlooked Variety of Big Businesses, in A.M. Colpan, T. Hikino (eds), Business Groups in the West: Origins, Evolution, and Resilience, OUP, 2018, pp. 165-192.

Goode R., Principles of Corporate Insolvency Law, 4th edn, Sweet and Maxwell, 2011.

Goode R., Principles of Corporate Insolvency Law, 3rd edn, Sweet & Maxwell, 2005.

Goode R., Gullifer L., Goode and Gullifer on Legal Problems of Credit and Security, 6th edn, Sweet & Maxwell, 2017.

Gordon J., Landry III R.J., The Risk-Shifting Effect of Business Bankruptcy: A Statutory Solution to Provide Additional Protections for Personal Guarantors of Debts by Closely-Held Business Ventures, Emory Bankruptcy Development Journal, Vol. 32, 2015, pp. 67-85.

Gordon J.N., Ringe W-G., Bank Resolution in the European Banking Union: A Transatlantic Perspective on What it Would Take, Columbia Law Review, Vol. 115, 2015, pp.1297-1370.

Graeber D., Debt: The First 5,000 Years, Melville House Publishing, 2011.

Greenberg J., Folger R., Procedural Justice, Participation, and the Fair Process Effect in Groups and Organizations, in P.B. Paulus (ed), Basic Group Process, Springer New York, NY, 1983, pp. 235-256.

Greer B.E., Moss J.S., Herther-Spiro N.B., Guarantees in Bankruptcy: A Primer II, Norton Annual Survey of Bankruptcy Law, 2014 edn, pp. 155-223.

Gribnau H., Legitimacy of the Judiciary, in E.H. Hondius, C. Joustra (eds), Netherlands Reports to the Sixteenth International Congress of Comparative Law, Intersentia, 2002, pp. 25-45.

Gruber J., Cross-default clauses in finance contracts, International Business Law Journal, No. 5, 1997, pp. 591-603.

Gullifer L., Payne J., Corporate Finance Law: Principles and Policy, 3rd edn, Hart Publishing, 2020.

Gullifer L., Payne J., Corporate Finance Law: Principles and Policy, 2nd edn, Hart Publishing, 2015.

Gunnarsson E.G., The Icelandic Regulatory Responses to the Financial Crisis, EBOR, Vol. 12, 2011, pp. 1-39.

Gurrea-Martínez A., Towards an optimal model of directors' duties in the zone of insolvency: an economic and comparative approach, Journal of Corporate Law Studies, Vol. 21, 2021, pp. 365-395.

Gurrea-Martínez A., Building a Restructuring Hub: Lessons from Singapore, SMU Yong Pung How School of Law Research Paper 16/2021, 11 October 2021.

Gurrea-Martínez A., Insolvency Law in Emerging Markets, Ibero-American Institute for Law and Finance, Working Paper 3/2020, 2020.
Gurrea-Martínez A., The Avoidance of Pre-Bankruptcy Transactions: An Economic and Comparative Approach, Chicago-Kent Law Review, Vol. 93, 2018, pp. 711-750.

Hadden T., Regulating Corporate Groups: An International Perspective, in J. McCahery, S. Picciotto and C. Scott (eds), Corporate Control and Accountability, Oxford: Clarendon Press, 1993, pp. 343-369.
Hadden T., Inside Corporate Groups, International Journal of the Sociology of Law, Vol. 12, 1984, pp. 271-286.
Hadfield G., Legal Infrastructure and the New Economy, I/S: A Journal of Law and Policy for the Information Society, Vol. 8, 2012, pp. 1-59.
Haentjens M., Party Autonomy, Public Policy and European Bank Insolvency Law, Hazelhoff Research Paper Series No. 7, 2015.
Haentjens M., Wessels B., Three Paradigm Shifts in Recent Bank Insolvency Law, Journal of International Banking Law and Regulation, Vol. 7, 2016, pp. 396-400.
Haentjens M., commentaar op art. 7:866 BW, in: S.E. Bartels (red.), Groene Serie Bijzondere overeenkomsten, Deventer: Wolters Kluwer (online).
Hahn D., The Roles of Acceleration, DePaul Business and Commercial Law Journal, Vol. 8, 2010, pp. 229-250.
Halpern P., Trebilcock M., Turnbull S., An Economic Analysis of Limited Liability in Corporation Law, University of Toronto Law Journal, Vol. 30, 1980, pp. 117-150.
Hansmann H., Kraakman R., Squire R., Law and the Rise of the Firm, Harvard Law Review, Vol. 119, 2006, pp. 1333-1403.
Hansmann H., Kraakman R., The End of History for Corporate Law, Georgetown Law Journal, Vol. 89, 2001, pp. 439-468.
Hansmann H., Kraakman R., The Essential Role of Organizational Law, The Yale Law Review, Vol. 110, 2000, pp. 387-440.
Hansmann H., Squire R., External and Internal Asset Partitioning: Corporations and Their Subsidiaries, in J.N. Gordon, W-G. Ringe (eds), The Oxford Handbook of Corporate Law and Governance, OUP, 2018, pp. 251-274.
Harari Y.N., Sapiens: A Brief History of Humankind, McClelland & Stewart, 2014.
Hardman D., Judgment and Decision-Making: Psychological Perspectives, BPS Blackwell, 2009.
Harmsen K., Lehman Brothers: een akkoord in strijd met de Faillissementswet, TvI 2013/28.
Harris J., Hargovan A., Potential liability for directors during corporate restructuring: comparative perspectives, in in P.J. Omar and J.L.L. Gant (eds), Research Handbook on Corporate Restructuring, Edward Elgar Publishing, 2021, pp. 143-165.
Harris R., A new understanding of the history of limited liability: an invitation for theoretical reframing, Journal of Institutional Economics, Vol. 16, 2020, pp. 643-664.
Harris R., Industrializing English Law: Entrepreneurship and Business Organization, 1720-1844, CUP, 2000.
Hartkamp A.S., Sieburgh C.H., Subrogatie in de rechten van de schuldeise, in A.S. Hartkamp & C.H. Sieburgh, Mr. C. Assers Handleiding tot de beoefening van het Nederlands Burgerlijk Recht. 6. Verbintenissenrecht. Deel I*. De verbintenis in het algemeen, eerste gedeelte, Deventer: Kluwer 2012.
Heller M.A., The Tragedy of the Anticommons: Property in the Transition from Marx to Markets, Harvard Law Review, Vol. 111, 1998, pp. 621-688.

Henkel C., Personal Guarantees and Sureties between Commercial Law and Consumers in the United States, The American Journal of Comparative Law, Vol. 62, 2014, pp. 333-359.

Hermans R., Vriesendorp R.D., Het dwangakkoord in het insolventierecht: vrijheid in gebondenheid? TvI 2014/10.

Herring R., The Challenge of Resolving Cross-Border Financial Institutions, Yale Journal on Regulation, Vol. 31, 2014, pp. 853-882.

Herring R.J., Carmassi J., The Corporate Structure of International Financial Conglomerates: Complexity and its Implications for Safety and Soundness, in A.N. Berger, P. Molyneux, J.O.S. Wilson (eds), The Oxford Handbook on Banking, OUP, 1st edn, 2012, pp. 195-230.

Heydon J.D., Leeming M.J., Turner P.G. (eds), Meagher, Gummow and Lehane's Equity Doctrines and Remedies, 5th edn, Chatswood: LexisNexis, 2015.

Hirte H., InsO § 39 Nachrangige Insolvenzgläubiger. Uhlenbruck, Insolvenzordnung: InsO. 15. Auflage 2019.

Ho A., The Treatment of Ipso Facto Clauses in Canada, McGill Law Journal, Vol. 61, 2015, pp. 139-189.

Ho L.C., Goode's Swan Song to Corporate Insolvency Law, European Business Law Review, Vol. 17, 2006, pp. 1727-1752.

Hoed J. den, commentaar op art. 6:10 BW, in: R.J.Q. Klomp & H.N. Schelhaas (red.), Groene Serie Verbintenissenrecht, Deventer: Wolters Kluwer (online).

Hoekstra G.D., De positie van de pandhouder in het faillissementsrecht (diss. Groningen), Den Haag: Boom Juridische Uitgevers 2007.

Hoffmann F., Konzernhandbuch, Wiesbaden: Gabler, 1993.

Hopt K.J., Groups of companies: A Comparative Study of the Economics, Law, and Regulation of Corporate Groups, in J.N. Gordon, W-G. Ringe (eds), The Oxford Handbook of Corporate Law and Governance, OUP, 2018, pp. 603-633.

Hopt K.J., Pistor K., Company Groups in Transition Economies: A Case for Regulatory Intervention? European Business Law Review, Vol. 2, 2001, pp. 1-43.

Hornuf L., Reps M., Schäferling S., Covenants in European investment-grade corporate bonds, Capital Markets Law Journal, Vol. 10, 2015, pp. 345-361.

Hotton L., Norris J., UK Corporate Insolvency and Governance Act: effects on ipso facto clauses, Butterworths Journal of International Banking and Financial Law, September 2020, pp. 550-552.

Hulse B.D., After the Guarantor Pays: The Uncertain Equitable Doctrines of Reimbursement, Contribution, and Subrogation, Real Property, Trust and Estate Law Journal, Vol. 51, 2016, pp. 41-74.

Hummelen J.M., commentaar op art. 136 Fw, in: A.J. Verdaas (red.), Groene Serie Faillissementswet, Deventer: Wolters Kluwer (online).

Hung M-W., Tsai W-H., Managerial optimism, CEO retention, and corporate performance: evidence from bankruptcy-filing firms, Journal of Economics and Finance, Vol. 44, 2020, pp. 506-526.

Jackson T.H., Bankruptcy's logic and limits in the 21st century: some thoughts on Chapter 11's evolution and future, in B.E. Adler (ed), Research Handbook on Corporate Bankruptcy Law, Edward Elgar Publishing, 2020, pp. 6-35.

Jackson T.H., The Logic and Limits of Bankruptcy Law, Harvard University Press, 1986.

Jackson T.H., Translating Assets and Liabilities to the Bankruptcy Forum, The Journal of Legal Studies, Vol. 14, 1985, pp. 73-114.

Jackson T.H., Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain, The Yale Law Journal, Vol. 91, 1982, pp. 857-907.
Janger E.J., Aggregation and Abuse: Mass Torts in Bankruptcy, Fordham Law Review, Vol. 91, 2022, pp. 362-383.
Janger E., The idea of rescue and the Chapter 11 model, in P.J. Omar and J.L.L. Gant (eds), Research Handbook on Corporate Restructuring, Edward Elgar Publishing, 2021, pp. 59-72.
Janger E.J., Madaus S., Value Tracing and Priority in Cross-Border Group Bankruptcies: Solving the Nortel Problem from the Bottom Up, University of Miami International and Comparative Law Review, Vol. 27, 2020, pp. 334-357.
Janger E.J., The Logic and Limits of Liens, University of Illinois Law Review, Vol. 2015, 2015, pp. 589-615.
Janger E.J., Pottow J.A.E., Implementing Symmetric Treatment of Financial Contracts in Bankruptcy and Bank Resolution, Brooklyn Journal of Corporate, Financial & Commercial Law, Vol. 10, 2015, pp. 155-181.
Jansen J. (ed), International Cash Pooling: Cross-border Cash Management Systems and Intra-group Financing, Sellier. European law publishers, 2011.
Janssen L.G.A., EU bank resolution framework: A comparative study on the relation with national private law, E.M. Meijers Instituut, 2020.
Jensen M.C., Meckling W.H., Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure, Journal of Financial Economics, Vol. 3, 1976, pp. 305-360.
Jonkers A.L., Insider guarantees in corporate finance: An economic analysis of Dutch, US and German law, PhD thesis, 2020.
Jonkers A.L., Selective Perforation by Means of Guarantees: Dutch Law, in The 800-Pound Gorilla. Limits to Group Structures and Asset Partitioning in Insolvency, NACIIL 2018 report, Eleven International Publishing, 2019, pp. 75-99.

Kahl M., Economic Distress, Financial Distress, and Dynamic Liquidation, The Journal of Finance, Vol. 57, 2002, pp. 135-168.
Kampshoff M., Behandlung von Bankdarlehen in der Krise der GmbH, GmbHR 2010, 897-904.
Kastrinou A., Vullings S., 'No Evil is without Good': A Comparative Analysis of Prepack Sales in the UK and the Netherlands, International Insolvency Review, Vol. 27, 2018, pp. 320-339.
Katz A.W., An Economic Analysis of the Guarantee Contract, The University of Chicago Law Review, Vol. 66, 1999, pp. 47-116.
Keay A., The Harmonization of the Avoidance Rules in European Union Insolvencies, International & Comparative Law Quarterly, Vol. 66, 2016, pp. 79-105.
Keay A., Insolvency Law: A Matter of Public Interest? Northern Ireland Legal Quarterly, Vol. 51, 2000, pp. 509-534.
Keay A., Walton P., The Preferential Debts' Regime in Liquidation Law: In the Public Interest? Company Financial and Insolvency Law Review, Vol. 3, 1999, pp. 84-105.
Kelsen H., Pure Theory of Law, The Lawbook Exchange Ltd., 2005 (originally published in 1934).
Kiersch E.D.G., commentaar op art. 2:403 BW, in: H.B. Krans, C.J.J.M. Stolker en W.L. Valk (red.), Tekst & Commentaar Burgerlijk Wetboek, Deventer: Wolters Kluwer (online).

Kilborn J., National Report for the United States, in D. Faber, N. Vermunt, J. Kilborn, T. Richter, I. Tirado (eds), Ranking and Priority of Creditors, OUP, 2016, pp. 571-595.

Kirshner J.A., International Bankruptcy: The Challenge of Insolvency in a Global Economy, University of Chicago Press, 2018.

Klaassen C.J.M., Hoofdelijkheid ofborgtocht, wat zal het wezen? WPNR 1998/6316, p. 347-351.

Klatt M., Meister M., The Constitutional Structure of Proportionality, OUP, 2012.

Kleinhaus E.A., Zuckerman P.B., The Enforceability of Ipso Facto Clauses in Financing Agreements: American Airlines and Beyond, Norton Journal of Bankruptcy Law and Practice, Vol. 23, 2014, pp. 193-211.

Kok H.G.F.M. de, Het regres (diss. Nijmegen), Deventer: Kluwer 1965.

Kokorin I., Preemptive Financing Arrangements within Cross-Border Banking Groups: Between Flexibility and Legal Certainty, in L. Böffel and J. Schürger (eds), Digitalisation, Sustainability, and the Banking and Capital Markets Union, Palgrave Macmillan Cham, 2022, pp. 377-395.

Kokorin I., Insolvency of Significant Non-Financial Enterprises: Lessons from Bank Failures and Bank Resolution, European Business Law Review, Vol. 32, 2021, pp. 521-556.

Kokorin I., The Future of Harmonisation of Directors' Duties in the EU: Restructuring Directive and Group Insolvencies, International Insolvency Review, Vol. 30, 2021, pp. 361-382.

Kokorin I., Promotion of group restructuring and cross-entity liability arrangements, Journal of Corporate Law Studies, Vol. 21, 2021, pp. 557-593.

Kokorin I., Third-Party Releases in Insolvency of Multinational Enterprise Groups, European Company and Financial Law Review, Vol. 18, 2021, pp. 107-140.

Kokorin I., The Rise of "Group Solution" in Insolvency Law and Bank Resolution, EBOR, Vol. 22, 2021, pp. 781-811.

Kokorin I., Contracting Around Insolvency Jurisdiction: Private Ordering in European Insolvency Jurisdiction Rules and Practices, in V. Lazić and S. Stuij (eds) Recasting the Insolvency Regulation: Improvements and Missed Opportunities, Asser Press, 2020, pp. 21-58.

Kokorin I., Conflicts of interest, intra-group financing and procedural coordination of group insolvencies, International Insolvency Review, Vol. 29, 2020, pp. 32-60.

Kokorin I., Intra-Group Financial Support in a Crisis: Between Rescue and Abuse, Norton Journal of Bankruptcy Law and Practice, Vol. 29, 2020, pp. 378-420.

Kokorin I., Co-ordination in bank resolution and the issue of conflicts of interest, Journal of International Banking Law and Regulation, Vol, 35, 2020, pp. 100-115.

Kokorin I., Madaus S., Mevorach I., Global Competition in Cross-Border Restructuring and Recognition of Centralized Group Solutions, Texas International Law Journal, Vol. 56, 2021, pp. 109-154.

Kokorin I., Wessels B., Cross-Border Protocols in Insolvencies of Multinational Enterprise Groups, Edward Elgar Publishing, 2021.

Kokorin I., Wessels B., annotation: European Court of Human Rights 5 July 2018, no. 41299/09 & 11132/10, *JOR* 2019, 3 (*JOR* 2019/64 *Boyadzhieva and Gloria International Limited Eood v. Bulgaria*), pp. 778-790.

König E., Single Point of Entry – a resolution strategy addressing the home – host issue in Europe's Banking Union, The SRB Blog, 22 April 2021.

König E., Real defragmentation of the Banking Union: the way forward, Eurofi, 17 December 2019.

Kortmann S.C.J.J., Het faillissement, een paradijs voor banken (afscheidsrede Nijmegen), Nijmegen: Radboud Universiteit 2017.
Kortmann S.C.J.J., Derden in het faillissementsrecht, Ars Aequi, 46, 1997, p. 54-60.
Kortmann S.C.J.J., Faber N.E.D. (red.), Geschiedenis van de Faillissementswet, heruitgave Van der Feltz, II, Deventer: Wolters Kluwer, 2016.
Kortmann S.C.J.J., Faber N.E.D. (red.), Geschiedenis van de Faillissementswet. Wetswijzigingen, Zwolle: W.E.J. Tjeenk Willink, 1995.
Kostoula T., Cross-Border Insolvency of Groups of Companies Under the Regulation (EU) 2015/848, European Company Law, Vol. 16, 2019, pp. 74-82.
Kraan J. van der, Toepassing en rechtskarakter van de groepsvrijstelling van artikel 2:403 BW (Serie Van der Heijden Instituut nr. 171), Deventer: Wolters Kluwer, 2022.
Kroeze M.J. (m.m.v. H. Beckman, M.A. Verbrugh), Mr. C. Assers Handleiding tot de beoefening van het Nederlands Burgerlijk Recht. 2. Rechtspersonenrecht. Deel I. De rechtspersoon, Deventer: Wolters Kluwer 2021.
Krohn A., Rethinking priority: The dawn of the relative priority rule and the new "best interests of creditors" test in the European Union, International Insolvency Review, Vol. 30, 2021, pp. 75-95.
Kuntz T., German corporate law in the 20th century, in H. Wells (ed), Research Handbook on the History of Corporate and Company Law, Edward Elgar Publishing, 2018, pp. 205-243.

Landuyt S., A Capital Question, A Capital Question, Should Shareholder Loans be Automatically Subordinated?, in D. Bruloot (ed), Belgian and European perspectives on creditor protection in closed companies, Intersentia, 2019, pp. 121-164.
Leahy J., Pearson S., Oi bankruptcy spotlights Brazilian debt problems, Financial Times, 21 June 2016.
Lee P.L., Bankruptcy Alternatives to Title II of the Dodd-Frank Act – Part I, The Banking Law Journal, Vol. 132, 2015, pp. 437-487.
Legg A., The Margin of Appreciation in International Human Rights Law: Deference and Proportionality, OUP, 2012.
Lehavi A., Property Law in a Globalized World, CUP, 2019.
Levitin A.J., Business Bankruptcy: Financial Restructuring and Modern Commercial Markets, Wolters Kluwer, 2016.
Li N., Lou Y., Vasvari F.P., Default clauses in debt contracts, Review of Accounting Studies, Vol. 20, 2015, pp. 1596-1637.
Licht A.N., My Creditor's Keeper: Escalation of Commitment and Custodial Fiduciary Duties in the Vicinity of Insolvency, Washington University Law Review, Vol. 98, 2021, pp. 1731-1764.
Lind E.A., Kanfer R., Earley P.C., Voice, Control, and Procedural Justice: Instrumental and Noninstrumental Concerns in Fairness Judgments, Journal of Personality and Social Psychology, Vol. 59, 1990, pp. 952-959.
Lipton P., The Mythology of Salomon's Case and the Law Dealing with the Tort Liabilities of Corporate Groups: An Historical Perspective, Monash University Law Review, Vol. 40, 2014, pp. 452-487.
Lomnicka E., Credit and security, in Chitty on Contracts, Vol II: Specific Contracts, 33rd edn, Sweet & Maxwell, 2018.
Loth M.A., Dwingend en aanvullend recht (Mon. BW A19), Wolters Kluwer, 2009.
Low K.F.K., Schuster E., Wan W.Y., The Company and Blockchain Technology, 29 October 2022, in C. Witting and M. Petrin (eds), Edward Elgar Handbook on Corporate Liability (Edward Elgar, forthcoming).

Lubben S.J., American Business Bankruptcy: A Primer, Edward Elgar Publishing, 2021.
Lubben S.J., A Functional Analysis of SIFI Insolvency, Texas Law Review, Vol. 96, 2018, pp. 1377-1402.
Lubben S.J., Subsidizing Liquidity or Subsidizing Markets: Safe Harbors, Derivatives, and Finance, American Bankruptcy Law Journal, Vol. 91, 2017, pp. 463-480.
Lubben S.J., Woo S.P., Reconceptualizing Lehman, Texas International Law Journal, Vol. 49, 2014, pp. 297-327.

Madaus S., Leaving the Shadows of US Bankruptcy Law: A Proposal to Divide the Realms of Insolvency and Restructuring Law, EBOR, Vol. 19, 2018, pp. 615-647.
Madaus S., On decision-making in rescue cases: why creditors and shareholders should decide about a rescue plan, in B. Santen and D. van Offeren (eds), Perspectives on international insolvency law: A tribute to Bob Wessels, Kluwer: Deventer, 2014, pp. 215-227.
Madaus S., Wilke A.K., Knauth P., Bringing Non-EU Insolvencies to Germany: Really so Different from the UNCITRAL Model Law on Cross-Border Insolvency? International Corporate Rescue, Vol. 17, 2020, pp. 21-28.
Mallon C., Waisman S.Y., Schrock R.C. (eds), The Law and Practice of Restructuring in the UK and US, OUP, 2011.
Mandel G., Patently Non-Obvious: Empirical Demonstration that the Hindsight Bias Renders Patent Decisions Irrational, Ohio State Law Journal, Vol. 67, 2006, pp. 1391-1463.
Manne H.G., Our Two Corporation Systems: Law and Economics, Virginia Law Review, Vol. 53, 1967, pp. 259-284.
Manove M., Padilla A.J., Pagano M., Collateral versus Project Screening: A Model of Lazy Banks, The RAND Journal of Economics, Vol. 32, 2001, pp. 726-744.
Mäntysaari P., The Law of Corporate Finance: General Principles and EU Law. Volume III: Funding, Exit, Takeovers, Springer, 2010.
Markell B.A., Owners, Auctions, and Absolute Priority in Bankruptcy Reorganizations, Stanford Law Review, Vol. 44, 1991, pp. 69-128.
Markesinis B., Fedtke J., Engaging with Foreign Law, Hart Publishing, 2009.
Martin N., The Role of History and Culture in Developing Bankruptcy and Insolvency Systems: The Perils of Legal Transplantation, Boston College International and Comparative Law Review, Vol. 28, 2005, pp. 1-77.
Martino E., The Bail-in Beyond Unpredictability: Creditors' Incentives and Market Discipline, EBOR, Vol. 21, 2020, pp. 789-828.
Massman S., ISDA Resolution Stay Protocol: A Brief Overview, Harvard Law School Bankruptcy Roundtable, 10 February 2015.
Maza S., Enjoying Third Party Litigation under §362, Norton Journal of Bankruptcy Law & Practice, Vol. 26, 2017 (online version).
Mba S., New Financing for Distressed Businesses in the Context of Business Restructuring Law, Springer, 2019.
McCormack G., National Report for the UK, in R. Bork, M. Veder (eds), Harmonisation of Transaction Avoidance Laws, Intersentia, 2022, pp. 1283-1314.
McCormack G., The European Restructuring Directive, Edward Elgar Publishing, 2021.
McCormack G., Keay A., Brown S., Dahlgreen J., Study on a new approach to business failure and insolvency, 2016.

McCormack G., Bankruptcy Forum Shopping: The UK and US as Venues of Choice for Foreign Companies, International and Comparative Law Quarterly, Vol. 63, 2014, pp. 815-842.
McDonald O., Lehman Brothers: A crisis of value, Manchester University Press, 2015.
McKendrick E., Contract Law: Text, Cases, and Materials, 6th edn, OUP, 2014.
Meier S., Recourse between Solidary Debtors, in N. Jansen, R. Zimmermann (eds), Commentaries on European Contract Laws, OUP, 2018.
Meilicke W., Das Eigenkapitalersatzrecht – eine deutsche Fehlentwicklung, GmbH-Rundschau, 2007, 225-236.
Mennens A.M., Het dwangakkoord buiten surseance en faillissement (Onderneming en recht nr. 118), Deventer: Wolters Kluwer, 2020.
Mevorach I., The Future of Cross-Border Insolvency: Overcoming Biases and Closing Gaps, OUP, 2018.
Mevorach I., Enterprise Groups in Insolvency: Recent International Developments, in J. Sarra (ed), Annual Review of Insolvency Law, Toronto: Carswell, 2013, p. 285ff.
Mevorach I., On the Road to Universalism: A Comparative and Empirical Study of UNCITRAL Model Law on Cross-Border Insolvency, EBOR, Vol. 12, 2011, pp. 517-557.
Mevorach I., Transaction Avoidance in Bankruptcy of Corporate Groups, ECFR, Vol. 8, 2011, pp. 235-258.
Mevorach I., Insolvency within Multinational Enterprise Groups, OUP, 2009.
Mevorach I., Walters A., The Characterization of Pre-insolvency Proceedings in Private International Law, EBOR, Vol. 21, 2021, pp. 855-894.
Miller D.J., Shakra M., *Nortel*: The Long and Winding Road, in J.P. Sarra and B. Romaine (eds), Annual Review of Insolvency Law, Toronto: Carswell, 2015.
Mitchell C., The Law of Contribution and Reimbursement, OUP, 2013.
Mitchell C., Watterson S., Subrogation: Law and Practice, OUP, 2007.
Mokal R.J., Corporate Insolvency Law: Theory and Application, OUP, 2005.
Mokal R.J., Priority as Pathology: The *Pari Passu* Myth, Cambridge Law Journal, Vol. 60, 2001, 581-621.
Mooney Jr. C.W., The Bankruptcy Code's Safe Harbors for Settlement Payments and Securities Contracts: When Is Safe Too Safe? Texas International Law Journal, Vol. 49, 2014, pp. 245-269.
Morrison D., Anderson C., The Australian Corporate Rescue Provisions: How do they Compare? In P. Omar (ed), International Insolvency Law: Reforms and Challenges. Ashgate, Farnham, 2013, pp. 171-206.
Moss G., Fletcher I., Isaacs S. (eds), Moss, Fletcher and Isaacs on the EU Regulation on Insolvency Proceedings, 3rd edn, OUP, 2016.
Moss G., Marks D., Rowlatt on Principal and Surety, 6th edn, Sweet & Maxwell, 2011.
Muchlinski P., Multinational Enterprises and the Law, 3d edn, OUP, 2021.
Muchlinski P., Multinational Enterprises and the Law, 2nd edn, OUP, 2007.
Muscat A., The Liability of the Holding Company for the Debts of its Insolvent Subsidiaries, Dartmouth Publishing Company, 1996.

Nass E., commentaar op art. 2:403 BW, in: J.B. Huizink (red.), Groene Serie Rechtspersonen, Deventer: Wolters Kluwer (online).
Neder Cerezetti S.C., Reorganization of Corporate Groups in Brazil: Substantive Consolidation and the Limited Liability Tale, International Insolvency Review, Vol. 30, 2021, pp. 169-190.

Nijkamp D.D., Steeg R.W.K., How certain elements of the Dutch scheme may (or may not) affect ISDA Master Agreements, Tijdschrift Financiering, Zekerheden en Insolventierechtpraktijk, No. 1, 2021, pp. 47-57.

Obenchain R., The Roman Law of Bankruptcy, The Notre Dame Lawyer, Vol. 3, 1928, pp. 169-200.
O'Donovan J., Lender Liability, English edn, Sweet & Maxwell, 2005.
Olaerts M., commentaar op art. 2:24b BW, in: J.B. Huizink (red.), Groene Serie Rechtspersonen, Deventer: Wolters Kluwer (online).
Olivares-Caminal R. et al., Debt Restructuring, 2nd edn, OUP, 2016.
Omar P.J., Gant J.L.L., Corporate Rescue in the United Kingdom: Past, Present and Future Reforms, Insolvency Law Journal, Vol. 24, 2016, pp. 40-61.
Oostrum C.H.A. van, Regres bij concernfinanciering (Serie Van der Heijden Instituut nr. 156) (diss. Leiden), Deventer: Wolters Kluwer, 2019.
Ophof H.P.J., Hoofdelijke aansprakelijkheid: solidariteit of apartheid? (Inaugurele rede Vrije Universiteit Amsterdam), Deventer: Kluwer 1987.
Orwell G., Animal Farm (1984).
Ostendorf P., Demand Guarantee or Suretyship Guarantee – Have corporate guarantors lost the benefit of the doubt? Oxford Business Law Blog, 14 September 2021.
Overduin J.H., Pool J.M.W., De curator in de spagaat: tussen Nederlandse taakuitoefening en het belang van een internationale herstructurering. Interview met curatoren Marcel Groenewegen (PTIF) en Jasper Berkenbosch (Oi Coop) over de voorlopige surseances en faillissementen van de financieringsmaatschappijen van Oi Telecom, Tijdschrift voor Insolventierecht, 2020/9, pp. 58-67.

Pacces A.M., Procedural and Substantive Review of Related Party Transactions: The Case for Noncontrolling Shareholder-Dependent Directors, in L. Enriques and T.H. Tröger (eds), The Law and Finance of Related Party Transactions, CUP, 2019, pp. 181-217.
Pennevis N.B., The European harmonisation of avoidance rules, a Dutch perspective on reshaping an age-old instrument, TvI 2023/12, pp. 77-88.
Pannevis N.B., Insolventierecht, Deventer: Wolters Kluwer, 2022.
Pannevis N.B., Achtergestelde vorderingen (Onderneming en recht nr. 114) (diss. Nijmegen), Deventer: Wolters Kluwer 2019.
Pargendler M., Regulatory partitioning as a key function of corporate personality, in E. Pollman and R.B. Thompson (eds), Research Handbook on Corporate Purpose and Personhood, Edward Elgar Publishing, 2021, pp. 263-282.
Pargendler M., The Grip of Nationalism on Corporate Law, Indiana Law Journal, Vol. 95, 2020, pp. 533-590.
Pargendler M., How Universal Is the Corporate Form? Reflections on the Dwindling of Corporate Attributes in Brazil, Columbia Journal of Transnational Law, Vol. 58, 2019, pp. 1-57.
Parry R. et al. (eds), Transaction Avoidance in Insolvencies, 3rd edn, OUP, 2018.
Paterson S., The analytical boundary between corporate reorganisation and sale in corporate bankruptcy theory, in P.J. Omar and J.L.L. Gant (eds), Research Handbook on Corporate Restructuring, Edward Elgar Publishing, 2021, pp. 525-538.
Paterson S., Corporate Reorganization Law and Forces of Change, OUP, 2020.
Paterson S., Debt Restructuring and Notions of Fairness, The Modern Law Review, Vol. 80, 2017, pp. 600-623.

Paterson S., Rethinking the Role of the Law of Corporate Distress in the Twenty-First Century, LSE Law, Society and Economy Working Papers 27/2014, 2014.
Paterson S., Walters A., Selective Corporate Restructuring Strategy, Modern Law Review, Vol. 86, 2023, pp. 436-464
Paulus C.G., Multinational Enterprises and National Insolvency Laws: Lobbying for Special Privileges, EBOR, Vol. 29, 2018, pp. 393-415.
Paulus C.G., The Wonderful World of Privileges – The Par Condicio Creditorum vs. Closeout-Netting, ECFR, Vol. 11, 2014, pp. 531-553.
Payne J., Schemes of Arrangement: Theory, Structure and Operation, CUP, 2021.
Payne J., An Assessment of the UK Restructuring Moratorium, Lloyd's Maritime and Commercial Law Quarterly, 2021, pp. 454-475.
Payne J., Schemes of Arrangement: Theory, Structure and Operations, CUP, 2014.
Payne J., Sarra J., Tripping the Light Fantastic: A Comparative Analysis of the European Commission's Proposals for New and Interim Financing of Insolvent Businesses, International Insolvency Review, Vol. 27, 2018, pp. 178-222.
Peacock L.L., A Tale of Two Courts: The Novel Cross-Border Bankruptcy Trial, American Bankruptcy Institute Law Review, Vol. 23, 2015, pp. 543-570.
Pepels S., Defining groups of companies under the European Insolvency Regulation (recast): on the scope of EU group insolvency law, International Insolvency Review, Vol. 30, 2021, pp. 96-123.
Phillips J., O'Donovan J., Courtney W., Philips and O'Donovan: Modern Contract of Guarantee, 4th edn, Sweet & Maxwell, 2020.
Pilkington C., Schemes of Arrangement in Corporate Restructuring, Sweet & Maxwell, 2017.
Pirker B., Proportionality Analysis and Models of Judicial Review: A Theoretical and Comparative Study, Europa Law Publishing, 2013.
Pistor K., The Code of Capital: How the Law Creates Wealth and Inequality, Princeton University Press, 2019.
Posner E.A., Casey A., A Framework for Bailout Regulation, Notre Dame Law Review, Vol. 91, 2015, pp. 479-536.
Posner R.A., Economic analysis of law, 8th edn, Aspen Publishers, 2011.
Posner R.A., The Crisis of Capitalist Democracy, HUP, 2010.
Posner R.A., The Rights of Creditors of Affiliated Corporations, University of Chicago Law Review, Vol. 43, 1975, pp. 499-526.
Pottow J.A.E., Love *Hertz*: Corporate Groups and Forum Selection, Texas International Law Journal, Vol. 56, 2021, pp. 155-180.
Pottow J.A.E., Cross-border corporate insolvency in the era of soft(ish) law, in B.E. Adler (ed), Research Handbook on Corporate Bankruptcy Law, Edward Elgar Publishing, 2020, pp. 329-362.
Pottow J.A.E., The Dialogic Aspect of Soft Law in International Insolvency: Discord, Digression, and Development, Michigan Journal of International Law, Vol. 40, 2019, pp. 479-503.
Pottow J.A.E., A New Approach to Executory Contracts, Texas Law Review, Vol. 96, 2018, pp. 1437-1472.
Pottow J.A.E., Two Cheers for Universalism: Nortel's Nifty Novelty, in J.P. Sarra, B. Romaine (eds), Annual Review of Insolvency Law, Toronto: Carswell, 2015, pp. 333-367.
Pottow J.A.E., Greed and Pride in International Bankruptcy: The Problems of and Proposed Solutions to 'Local Interests', Michigan Law Review, Vol. 104, 2006, pp. 1899-1949.
Prak M., Zanden J.L. van, Pioneers of Capitalism, Princeton University Press, 2022.

Pretelli I., Cross-Border Credit Protection Against Fraudulent Transfers of Assets: Actio Pauliana in the Conflict of Laws, Yearbook of Private International Law, Vol. 13, 2011, pp. 589-640.

Radin M., Guarantee and Suretyship, California Law Review, Vol. 17, 1929, pp. 605-622.

Ramsay I., Personal Insolvency in the 21st Century: A Comparative Analysis of the US and Europe, Hart Publishing, 2017.

Rajak H., The Culture of Bankruptcy, in P.J. Omar (ed), International insolvency law. Themes and perspectives, Routledge, London and New York, 2008, pp. 3-25.

Rajak H., Insolvency Law: Theory and Practice, Sweet & Maxwell, 1993.

Ramesh K., Synthesising Synthetics: Lessons learnt from Collins & Aikman, 2nd Annual GRR Live New York, 26 September 2018.

Ramos Muñoz D., Lamandini M., Evolving key risks in the banking sector and related priorities for the SRB: the lack of an effective transfer-based bank crisis framework, November 2022, pp. 1-19.

Rank W.A.K., Van saldocompensatie naar saldoconcentratie?, MvV 2018, afl. 11, p. 327-341.

Rank W.A.K., Een paarlen jubileum voor de ISDA Master Agreement: 30 jaar contractszekerheid voor OTC-derivaten, Tijdschrift voor Financieel Recht, afl. 4, 2017, p. 117-128.

Rank W.A.K., Spanje W. van, Dutch Lehman jitters? Butterworths Journal of International Banking and Financial Law, February 2009, pp. 89-92.

Rasmussen R.K., The end of bankruptcy revisited, in B.A. Adler (ed), Research Handbook on Corporate Bankruptcy Law, Edward Elgar Publishing, 2020, pp. 36-53.

Rasmussen R.K., Taking Control Rights Seriously, University of Pennsylvania Law Review, Vol. 166, 2018, pp. 1749-1776.

Rasmussen R.K., Guarantees and Section 548(a)(2) of the Bankruptcy Code, The University of Chicago Law Review, Vol. 52, 1985, pp. 194-217.

Rawls J., A Theory of Justice, Harvard University Press, 1999 (originally published in 1971).

Raz J., The Authority of Law: Essays on Law and Morality, Clarendon Press, 1979.

Raz J., Legal Principles and the Limits of Law, The Yale Law Journal, Vol. 81, 1972, pp. 823-854.

Reinhardt D., Riddiough S.J., The Two Faces of Cross-Border Banking Flows, IMF Economic Review, Vol. 63, 2015, pp. 751-791.

Renssen S., De herijking van het faillissementsrecht. De WHOA (Recht & Praktijk, nr. InsR17), Deventer: Wolters Kluwer 2021.

Renssen S., De herijking van het faillissementsrecht. De pijler modernisering (Recht en Praktijk nr. InsR12), Deventer: Wolters Kluwer, 2019.

Ringe W-G., Patel J., The Dark Side of Bank Resolution: Counterparty Risk through Bail-in, EBI Working Paper Series 2019, No. 31, 2019.

Robert-Tissot F., 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.

Roe M.J., Derivatives and repos in bankruptcy, in B.E. Adler (ed), Research Handbook on Corporate Bankruptcy Law, Edward Elgar Publishing, 2020, pp. 102-123.

Roe M.J., Three Ages of Bankruptcy, Harvard Business Law Review, Vol. 7, 2017, pp. 187-219.

Roe M.J., Corporate Strategic Reaction to Mass Tort, Virginia Law Review, Vol. 72, 1986, pp. 1-59.

Roe M.J., F. Tung, Breaking Bankruptcy Priority: How Rent-Seeking Upends the Creditors' Bargain, Virginia Law Review, Vol. 99, 2013, pp. 1235-1290.
Roover R. De, The rise and decline of the Medici Bank, 1397-1494, HUP, 1963.
Roover R. De, The Medici Bank: Organization and Management, The Journal of Economic History, Vol. 6, 1946, pp. 24-52.

Sáez Lacave M., Gutiérrez Urtiaga M., Corporate Groups: Corporate Law, Private Contracting and Equal Ownership, ECGI Law Working Paper No 581, 2021.
Sandel M., Justice: What's the Right Thing to Do? 1st edn, Farrar, Straus and Giroux, 2010.
Saltane V., Serna P.G., Why are minimum capital requirements a concern for entrepreneurs? World Bank Doing Business, 2014, pp. 41-45.
Sarra J., Payne J., Madaus S., The Promise and Perils of Regulating Ipso Facto Clauses, International Insolvency Review, Vol. 31, 2022, pp. 45-80.
Sautner Z., Vladimirov V., Indirect Costs of Financial Distress and Bankruptcy Law: Evidence from Trade Credit and Sales, Review of Finance, Vol. 22, 2018, pp. 1667-1704.
Scarlino D., Zone of Insolvency, Directors' Duties and Creditors' Protection in U.S., European Business Law Review, Vol. 29, 2018, pp. 1-32.
Schaick A.C. van, Mr. C. Assers Handleiding tot de beoefening van het Nederlands Burgerlijk Recht. 7. Bijzondere overeenkomsten. Deel VIII. Bewaarneming, borgtocht, vaststellingsovereenkomst, bruikleen, altijddurende rente, spel en weddenschap, Deventer: Wolters Kluwer 2018.
Schaick A.C. van, Het glibberige pad van de verjaring van de regresvordering, *NTBR* 2012/55, p. 420-430.
Schauer F., The Force of Law, HUP, 2015.
Schelhaas H.N., Redelijkheid en billijkheid (Monografieen BW), Wolters Kluwer, 2017.
Scheuch A., *Konzernrecht*: An Overview of the German Regulation of Corporate Groups and Resulting Liability Issues, European Company Law, Vol. 13, 2016, pp. 191-198.
Schillig M., Resolution and Insolvency of Banks and Financial Institutions, OUP, 2016.
Schoenmaker D., The impact of the legal and operational structures of euro-area banks on their resolvability, Policy Contribution, Issue 23, 2016, pp. 1-14.
Schoenmaker D., Governance of International Banking: The Financial Trilemma, OUP, 2013.
Schmidt J., Corporate groups, in P.J. Omar and J.L.L. Gant (eds), Research Handbook on Corporate Restructuring, Edward Elgar Publishing, 2021, pp. 214-227.
Schmidt K., Vom Eigenkapitalersatz in der Krise des Eigenkapitalersatzrechts? GmbH-Rundschau, 2005.
Schroeder J.L., Carlson D.G., Third Party Releases Under the Bankruptcy Code After Purdue Pharma, Cardozo Legal Studies Research Paper No. 681, 2022.
Schuijling B.A., Veder M., National Report for the Netherlands, in R. Bork and M. Veder (eds), Harmonisation of Transaction Avoidance Laws, Intersentia, 2022, pp. 1043-1077.
Schütze R., Tridimas T. (eds), Oxford Principles of European Union Law. Volume I: The European Union Legal Order, OUP, 2018.
Schwarcz S.L., Beyond Bankruptcy: Resolution as a Macroprudential Regulatory Tool, Notre Dame Law Review, Vol. 94, 2018, pp. 709-749.

Schwarcz S.L., Regulating Complexity in Financial Markets, Washington University Law Review, Vol. 87, 2009, pp. 211-268.
Schwarcz S.L., Collapsing Corporate Structures: Resolving the Tension Between Form and Substance, The Business Lawyer, Vol. 60, 2004, pp. 109-145.
Schwarcz S.L., Rethinking Freedom of Contract: A Bankruptcy Paradigm, Texas Law Review, Vol. 77, 1999, pp. 515-604.
Sen A., The Idea of Justice, HUP, 2009.
Resnick A.N., Scheler B.E., From the Bankruptcy Courts: The Effect of a Cross-Default Provision on the Ability to Assume an Executory Contract or Unexpired Lease, Uniform Commercial Code Journal, Vol. 32, 2000, pp. 338-343.
Sexton A.V., Current Problems and Trends in the Administration of Transnational Insolvencies Involving Enterprise Groups: the Mixed Record of Protocols, the UNCITRAL Model Insolvency Law, and the EU Insolvency Regulation, Chicago Journal of International Law, Vol. 12, 2012, pp. 811-840.
Shaydullin A., Subordination of shareholder claims in insolvency law, PhD dissertation, 2022.
Sherrill M.D., In Defense of the Bankruptcy Code's Safe Harbors, The Business Lawyer, Vol. 70, 2015, pp. 1007-1037.
Sieburgh C.H., Mr. C. Assers Handleiding tot de beoefening van het Nederlands Burgerlijk Recht. 6. Verbintenissenrecht. Deel III. Algemeen overeenkomstenrecht, Deventer: Wolters Kluwer 2022.
Sieburgh C.H., Mr. C. Assers Handleiding tot de beoefening van het Nederlands Burgerlijk Recht. 6. Verbintenissenrecht. Deel II. De verbintenis in het algemeen, tweede gedeelte, Deventer: Wolters Kluwer 2021.
Sieburgh C.H., Mr. C. Assers Handleiding tot de beoefening van het Nederlands Burgerlijk Recht. 6. Verbintenissenrecht. Deel I. De verbintenis in het algemeen, eerste gedeelte, Deventer: Wolters Kluwer 2020.
Sieburgh C.H., Mr. C. Assers Handleiding tot de beoefening van het Nederlands Burgerlijk Recht. 6. Verbintenissenrecht. Deel III. Algemeen overeenkomstenrecht, Deventer: Wolters Kluwer 2018.
Siems M., Comparative Law, 2nd edn, CUP, 2018.
Sigron M., Legitimate Expectations under Article 1 of Protocol No. 1 to the European Convention on Human Rights, Intersentia, 2014.
Sigtenhorst R. van den, commentaar op art. 372 Fw, in: J.L.M. Groenewegen en F.M.J. Verstijlen (red.), Tekst & Commentaar Insolventierecht, Deventer: Wolters Kluwer (online).
Sigtenhorst R. van den, Herstructurering van groepen onder de WHOA, in C.M. Harmsen & M.L.H. Reumers (red.), De WHOA van wet naar recht (Recht & Praktijk, nr. InsR18), Deventer: Wolters Kluwer 2021.
Silverstein J.M., Overlooking Tort Claimants' Best Interests: Non-Debtor Releases in Asbestos Bankruptcies, UMKC Law Review, Vol. 78, 2009, pp. 1-100.
Simon L.D., Bankruptcy Grifters, The Yale Law Journal, Vol. 131, 2022, pp. 1154-1216.
Singh D., European Cross-Border Banking and Banking Supervision, OUP, 2020.
Skeel D.A., The new synthesis of bank regulation and bankruptcy in the Dodd-Frank era, in B.E. Adler (ed), Research Handbook on Corporate Bankruptcy Law, Edward Elgar Publishing, 2020, pp. 66-101.
Skeel D.A., The Empty Idea of "Equality of Creditors", University of Pennsylvania Law Review, Vol. 166, 2018, pp. 699-744.
Skeel D.A., Single Point of Entry and the Bankruptcy Alternative, in M.N. Baily and J.B. Taylor (eds), Across the Great Divide: New Perspectives on the Financial Crisis, Hoover Press, 2014, pp. 311-333.

Skeel D.A., Icarus in the Boardroom: The Fundamental Flaws in Corporate America and Where They Came From, OUP, 2005.
Skeel D.A., The Past, Present and Future of Debtor-in-Possession Financing, Cardozo Law Review, Vol. 25, 2004, pp. 1905-1934.
Skeel D.A., Creditors' Ball: The New Corporate Governance in Chapter 11, University of Pennsylvania Law Review, Vol. 152, 2003, pp. 917-951.
Skeel D.A., Debt's Dominion: A History of Bankruptcy Law in America, Princeton University Press, 2001.
Skeel D.A., An Evolutionary Theory of Corporate Law and Corporate Bankruptcy, Vanderbilt Law Review, Vol. 51, 1998, pp. 1325-1398.
Skeel D.A., Krause-Vilmar G., Recharacterization and the Nonhindrance of Creditors, EBOR, Vol. 7, 2006, pp. 259-285.
Skeel D.A., Triantis G., Bankruptcy's Uneasy Shift to a Contract Paradigm, University of Pennsylvania Law Review, Vol. 166, 2018, pp. 1777-1818.
Smith L., Security, in A. Burrows (ed), Principles of English Commercial Law, OUP, 2015.
Smith S., Contract Theory, OUP, 2004.
Soedira A.D.W., Het Akkoord. Een wetenschappelijke proeve op het gebied van de rechtsgeleerdheid (Onderneming en recht, nr. 60) (diss. Nijmegen), Deventer: Kluwer, 2011.
Solinge G. van, Nieuwe Weme M.P., Mr. C. Assers Handleiding tot de beoefening van het Nederlands burgerlijk recht. 2. Rechtspersonenrecht. Deel II*. De naamloze en besloten vennootschap, Deventer: Kluwer, 2009.
Sommer H.J., Levin R., Collier on Bankruptcy, 16th edn, 2022.
Sørensen K.E., The Legal Position of Parent Companies: A Top-Down Focus on Group Governance, EBOR, Vol. 22, 2021, pp. 433-474.
Sørensen K.E., Groups of Companies in the Case Law of the Court of Justice of the European Union, European Business Law Review, Vol. 27, 2016, pp. 393-420.
Soveral Martins A. de, Groups of companies in the Recast European Insolvency Regulation: Around and about the "group", International Insolvency Review, Vol. 28, 2019, pp. 354-362.
Spahos D., Lenders, Borrowing Groups of Companies and Corporate Guarantees: An Insolvency Perspective, Journal of Corporate Law Studies, Vol. 1, 2001, pp. 333-357.
Squire R., Distress-triggered liabilities and the agency costs of debt, in B.E. Adler (ed), Research Handbook on Corporate Bankruptcy Law, Edward Elgar Publishing, 2020, pp. 124-149.
Squire R., Limits to Group Structures and Asset Partitioning in Insolvency: Suppressing Value and Selective Perforation by Means of Guarantees, in The 800-Pound Gorilla. Limits to Group Structures and Asset Partitioning in Insolvency, NACIIL 2018 report, Eleven International Publishing, 2019, pp. 1-19.
Squire R., Strategic Liability in Corporate Groups, The University of Chicago Law Review, Vol. 78, 2011, pp. 605-669.
Squire R., Shareholder Opportunism in a World of Risky Debt, Harvard Law Review, Vol. 123, 2010, pp. 1151-1213.
Stanghellini L., Mokal R., Paulus C.G., Tirado I. (eds), Best Practices in European Restructuring. Contractualised Distress Resolution in the Shadow of the Law, Wolters Kluwer, 2018.
Steele S., Ramsay I., Webster M., Insolvency law reform in Australia and Singapore: Directors' liability for insolvent trading and wrongful trading, International Insolvency Review, Vol. 28, 2019, pp. 363-391.

Stein D.F.H., Verjaring van wettelijke regresvorderingen en de 'afzonderlijke elementen-leer', AV&S 2020/26, p. 157-166.
Stein D.F.H., Tweehuysen V., Bartels S.E. (red.), Verjaring, Deventer: Wolters Kluwer, 2020.
Strohmaier N. et al., Hindsight bias and outcome bias in judging directors' liability and the role of free will beliefs, Journal of Applied Social Psychology, Vol. 51, 2020, pp. 141-158.
Sun L., The Fairness Instinct: The Robin Hood Mentality and Our Biological Nature, Prometheus Books, 2013.
Symes C., Harris J., Be Careful What You Wish For! Evaluating the Ipso Facto Reforms, OBLB, 13 September 2019.

Tabb C.J., Law of Bankruptcy, 4th edn, West Academic Publishing, 2016.
Tabb C.J., The Bankruptcy Clause, the Fifth Amendment, and the Limited Rights of Secured Creditors in Bankruptcy, University of Illinois Law Review, Vol. 2015, 2015, pp. 765-809.
Tabb C.J., The History of the Bankruptcy Laws in the United States, ABI Law Review, Vol. 3(1), 1995, pp. 5-51.
Tan M., Han K., A Comparative Look at the Ipso Facto Regime, Singapore Academy of Law, SAL Prac 1, 2021.
Teichmann C., Towards a European Framework for Cross-Border Group Management, European Company Law, Vol. 13, 2016, pp. 150-157.
Tett G., Global debt is soaring – and we need to talk about it, Financial Times, 16 September 2021.
Thibaut J., Walker L., A theory of procedure, *California Law Review*, Vol. *66*, 1978, pp. 541-566.
Thole C., Dueñas M., Some Observations on the New Group Coordination Procedure of the Reformed European Insolvency Regulation, International Insolvency Review, Vol. 24, 2015, pp. 214-227.
Tirado I., Scheming against the Schemes: A New Framework to Deal with Business Financial Distress in Spain, ECFR, Vol. 15, 2018, pp. 516-552.
Tjittes R.P.J.L., Commercieel contractenrecht, Deel I Totstandkoming en inhoud, Den Haag: Boom Juridisch 2018.
Tollenaar N., Pre-Insolvency Proceedings: A Normative Foundation and Framework, OUP, 2018.
Tollenaar N.W.A., Het pre-insolventieakkoord. Grondslagen en raamwerk (diss. Groningen), Deventer: Wolters Kluwer 2016.
Tolstoy L., Anna Karenina (1877).
Tomasello M., Vaish A., Origins of Human Cooperation and Morality, Annual Review of Psychology, Vol. 64, 2013, 231-255.
Toube F., Rumley J., A Brave New World? Should the UK Ban Ipso Facto Clauses in Non-Executory Contracts? Insolvency Intelligence, 31(3), 2018, p. 78ff.
Trebilcock M.J., The Limits of Freedom of Contract, Harvard University Press, 1997.
Triantis G.G., Organizations as Internal Capital Markets: The Legal Boundaries of Firms, Collateral, and Trusts in Commercial and Charitable Enterprises, Harvard Law Review, Vol. 117, 2004, pp. 1102-1162.
Triantis G.G., A Theory of the Regulation of Debtor-in-Possession Financing, Vanderbilt Law Review, Vol. 46, 1993, pp. 901-935.
Tsioli L., Rescue financing under a 'viability spotlight', Journal of Corporate Law Studies, Vol. 22, 2022, pp. 843-885.

Tsioli L., Viability assessment in corporate debt restructuring: Optimizing the filtration effect of the European directive on restructuring and insolvency, Norton Journal of Bankruptcy Law and Practice, Vol. 30, 2021, pp. 397-447.

Tucker M.R., Debt Recharacterization During an Economic Trough: Trashing Historical Tests to Avoid Discouraging Insider Lending, Ohio State Law Journal, Vol. 71, 2010, pp. 187-228.

Uzal M.E., National Report on Argentina, in R.M. Manóvil (ed), Groups of Companies: A Comparative Law Overview, Springer, 2020, pp. 591-625.

Vaccari E., The normative and jural meanings of the anti-deprivation principle *vis-à-vis* freedom of contract, International Insolvency Review, Vol. 31, 2022, pp. 235-274.

Valsan R., National Report on the United Kingdom, in R.M. Manóvil (ed), Groups of Companies: A Comparative Law Overview, Springer, 2020, pp. 627-658.

Valukas A.R., Byman R.L., Murray D.R., The Rise and Fall of Lehman Brothers, in D. Faber and N. Vermunt (eds), Bank Failure: Lessons from Lehman Brothers, OUP, 2017, pp. 3-30.

Veder M., Party Autonomy and Insolvency Law, in R. Westrik, J. van der Weide (eds), Party Autonomy in International Property Law, Sellier European Law Publishers, 2011, pp. 261-276.

Veder M., Thery A., The release of third party guarantees in pre-insolvency restructuring plans, in D. Faber, B. Schuijling and N. Vermunt (eds), Trust and Good Faith across Borders, Liber Amicorum Prof. Dr. S.C.J.J. Kortmann, Wolters Kluwer, 2017, pp. 259-274.

Ventoruzzo M., Sandrelli G., O Tell Me the Truth about Bail-In: Theory and Practice, Journal of Business, Entrepreneurship & the Law, Vol. 13, 2020, pp. 187-316.

Verheul E.F., commentaar op art. 57 Fw, in: A.J. Verdaas (red.), Groene Serie Faillissementswet, Deventer: Wolters Kluwer (online).

Verhoeven F., Lehman Brothers Treasury, in M. Haentjens and B. Wessels (eds), Research Handbook on Cross-Border Bank Resolution, Edward Elgar Publishing, 2019, pp. 344-358.

Verse D.A., Shareholder Loans in Corporate Insolvency – A New Approach to an Old Problem, German Law Journal, Vol. 9, 2008, pp. 1109-1124.

Verstijlen F.M.J., commentaar op art. 136 Fw, in: J.L.M. Groenewegen en F.M.J. Verstijlen (red.), Tekst & Commentaar Insolventierecht, Deventer: Wolters Kluwer (online).

Verstijlen F.M.J., Ondersteunende voorzieningen in de WHOA, TvI 2020/4.

Verstijlen F.M.J., Flankerende voorzieningen in de Wet Homologatie onderhands akkoord ter voorkoming van faillissement, in Preadviezen van de Vereniging Handelsrecht, Uitgeverij Paris, 2017.

Verstijlen F.M.J., De betrekkelijke continuïteit van het contract binnen faillissement, in W.J.M. van Andel & F.M.J. Verstijlen, Materieel faillissementsrecht: de Peeters/Gatzen-vordering en de overeenkomst binnen faillissement. Preadviezen 2006 uitgebracht voor de Vereniging voor Burgerlijk Recht, Kluwer: Deventer 2006.

Verstijlen F.M.J., Nieuwstadt F.M. van, Stelling: De separatistenpositie voor zekerheidsgerechtigden moet worden afgeschaft, TvI 2005/14.

Verstijlen F.M.J., De faillissementscurator, W.E.J. Tjeenk Willink, 1998.

Vinter G.D., Project Finance: A Legal Guide, 3rd edn, Sweet & Maxwell, 2006.

Virgós M., Garcimartín F., The European Insolvency Regulation: Law and Practice, Kluwer Law International, 2004.

Virgós M., Schmit E., Report on the Convention on Insolvency Proceedings, 1996.
Vriesendorp R.D., Insolventierecht, 2e druk, Deventer: Wolters Kluwer, 2021.
Vriesendorp R.D., Enkele grenzen van artikel 47 Fw verkend: een machtig wapen voor de curator of een dode letter, Insolad Jaarboek 2014, Deventer: Kluwer, 2015, p. 165-193.
Vriesendorp R.D., Insolventierecht, Deventer: Wolters Kluwer, 2013.
Vriesendorp R.D., Art. 47 FW: een geamputeerde tentakel of verdient de curator meer? in S.C.J.J. Kortmann e.a. (red.), De curator, een octopus, Zwolle: W.E.J. Tjeenk Willink, 1996, p. 65-79.
Vriesendorp R.D., Hengst F., Elkerbout-Kok R., One year and 100 court decisions later: Dutch restructuring scheme in practice, 23 March 2022.
Vriesendorp, R.D., Hengst, F.J.M., Kesteren, W.J.J. van, Lynch Fannon, I., Nickels, M., Nerriec, B. Restructuring Cross Border Groups: Key Considerations Around Foreign Tax and Finance Driven SPVs. INSOL Special Report. London: INSOL International, 2020.
Vriesendorp R.D., Hermans R.M., Vries K.A.J. de, Herijking faillissementsrecht en het informeel akkoord: gemiste kans of opportunity voor een Nederlandse scheme of arrangement? TvI 2013/12.

Walters A., United States' bankruptcy jurisdiction over foreign entities: exorbitant or congruent? Journal of Corporate Law Studies, Vol. 17, 2017, pp. 367-404.
Walton P., Umfreville C., Jacobs L., A snapshot of company voluntary arrangements: Success, failure and proposals for reform, International Insolvency Review, Vol. 29, 2020, pp. 267-284.
Wan W.Y., Watters C., McCormack G., Schemes of Arrangement in Singapore: Empirical and Comparative Analyses, American Bankruptcy Law Journal, Vol. 94, 2020, pp. 463-505.
Warner G. Ray, Comparative collectivity: European Union and United States approaches, International Insolvency Review, Vol. 32, 2023, pp. 156-175.
Warner G. Ray, Veder M., Enterprise Group Restructuring: Dutch Options and United States Enforcement, European Insolvency and Restructuring Journal, 2021-7, 2021, pp. 1-52.
Warner G. Ray, Conflicting Norms: Impact of the Model Law on Chapter 11's Global Restructuring Role, International Insolvency Review, Vol. 28, 2019, pp. 273-286.
Warren E., Bankruptcy Policymaking in an Imperfect World, Michigan Law Review, Vol. 92, 1993, pp. 336-387.
Warren E., Bankruptcy Policy, The University of Chicago Law Review, Vol. 54, 1987, pp. 775-814.
Warren E., Westbrook J.L., The Success of Chapter 11: A Challenge to the Critics, Michigan Law Review, Vol. 107, 2009, pp. 603-642.
Wee M.S., The Singapore Story of Injecting US Chapter 11 into the Commonwealth Scheme, ECFR, Vol. 15, 2018, pp. 553-584.
Weijden R.J. van der, commentaar op art. 6:150 BW, in: R.J.Q. Klomp & H.N. Schelhaas (red.), Groene Serie Verbintenissenrecht, Deventer: Wolters Kluwer (online).
Weijden R.J. van der, Wetenschap van benadeling in de zin van art. 42 Fw en de voorzienbaarheid van het faillissement van de schuldenaar, MvV, afl. 10, 2017, p. 285-289.
Weijden R.J. van der, De faillissementspauliana (Onderneming en recht nr. 75) (diss. Nijmegen), Deventer: Kluwer, 2012.

Weijs R.J. de, Harmonization of European Insolvency Law: Preventing Insolvency Law from Turning against Creditors by Upholding the Debt-Equity Divide, ECFR, Vol. 2, 2018, pp. 403-444.
Weijs R.J. de, Harmonisation of European Insolvency Law and the Need to Tackle Two Common Problems: Common Pool and Anticommons, International Insolvency Review, Vol. 21, 2012, pp. 67-83.
Weijs R.J. de, Faillissementspauliana, Insolvenzanfechtung en Transaction Avoidance in Insolvencies. Naar een geobjectiveerde regeling van schuldeisersbenadeling (Recht en Praktijk nr. InsR1) (diss. Amsterdam UvA), Deventer: Kluwer 2010.
Weijs R.J. de, Baltjes M., Opening the Door for the Opportunistic Use of Interim Financing: A Critical Assessment of the EU Draft Directive on Preventive Restructuring Frameworks, International Insolvency Review, Vol. 27, 2018, pp. 223-254.
Weijs R.J. de, Good M., Shareholders' and creditors' entitlements on insolvency: who wins where? Butterworths Journal of International Banking and Financial Law, November 2015, pp. 642-645.
Weijs R.J. de, Heems D.G.J., commentaar op art. 42 Fw, in: A.J. Verdaas (red.), Groene Serie Faillissementswet, Deventer: Wolters Kluwer (online).
Weijs R.J. de, Vries J. de, Jonkers A., Corporate Finance for Lawyers, Edward Elgar Publishing, 2023.
Weinrib E.J., The Idea of Private Law, OUP, 2012.
Welling-Steffens L., Ellias J.A., van den Berg S.W., Florstedt T., Distressed Debt Trading – Brave New EU Legal Rules in Relation to Bold New Strategies, NACIIL 2018 report, Eleven International Publishing, 2019.
Wells C., Doulai A., Till default do us part: facility agreements and acceleration, Butterworths Journal of International Banking and Financial Law, October 2013, pp. 571-575.
Wessels B., Vereffening van de boedel (Wessels Insolventierecht nr. VII), 5e druk, Deventer: Wolters Kluwer, 2021.
Wessels B., Het Akkoord (Wessels Insolventierecht nr. VI), 5e druk, Deventer: Wolters Kluwer, 2020.
Wessels B., Gevolgen van faillietverklaring (Wessels Insolventierecht nr. III), 5e druk, Deventer: Wolters Kluwer, 2019.
Wessels B., Weijs R.J. de (ed), International Contributions to the Reform of Chapter 11 U.S. Bankruptcy Code, Eleven International Publishing, 2015.
Wessels B., Moeten schuldeisers altijd gelijk behandeld worden? Nederlands Juristenblad, Aflevering 6, 2010, p. 334-340.
Wessels B., Madaus S. (eds), Rescue of Business in Europe: A European Law Institute Instrument, OUP, 2020.
Wessels B., Kokorin I., European Union Regulation on Insolvency Proceedings: An Introductory Analysis, Alexandria: American Bankruptcy Institute, 2018.
Wessels B., Madaus S., Rescue of Business in Insolvency Law. Instrument of the ELI, 2017.
Westbrook J.L., Transparency in Corporate Groups, Brooklyn Journal of Corporate, Financial & Commercial Law, Vol. 13, 2018, pp. 33-52.
Westbrook J.L., Corporate Formalism in a Global Economy, in J.P. Sarra and B. Romaine (eds), Annual Review of Insolvency Law, Toronto: Carswell, 2015.
Westbrook J.L., Commercial Law and the Public Interest, Penn State Journal of Law and International Affairs, Vol. 4, 2015, pp. 445-458.
Westbrook J.L., The Control of Wealth in Bankruptcy, Texas Law Review, Vol. 82, 2004, pp. 795-862.

Westbrook J.L., A Functional Analysis of Executory Contracts, Minnesota Law Review, Vol. 74, 1989, pp. 227-338.
Westbrook J.L., White K.S., The Demystification of Contracts in Bankruptcy, American Bankruptcy Law Journal, Vol. 91, 2017, pp. 481-562.
Wetzer T., In Two Minds: The Governance of Ring-Fenced Banks, Journal of Corporate Law Studies, Vol. 19, 2019, pp. 197-249.
Wheaton C., Clearing a Minefield of Insolvency Law: Toward Debt Recharacterization as a Supplement to the Bankruptcy Code, Santa Clara Law Review, Vol. 55, 2015, pp. 769-798.
Whittaker S., Suretyship, in Chitty on Contracts, 34th edn, Sweet & Maxwell, 2021.
Whittaker S., Suretyship, in Chitty on Contracts, 33d edn, Sweet & Maxwell, 2018.
Widen W.H., Report to the American Bankruptcy Institute: Prevalence of Substantive Consolidation in Large Public Company Bankruptcies from 2000 to 2005, American Bankruptcy Institute Law Review, Vol. 16, 2008, pp. 1-36.
Widen W.H., Corporate Form and Substantive Consolidation, George Washington Law Review, Vol. 75, 2007, pp. 237-328.
Widen W.H., Prevalence of Substantive Consolidation in Large Bankruptcies from 2000 to 2004: Preliminary Results, American Bankruptcy Institute Law Review, Vol. 14, 2006, pp. 47-68.
Wiggins R.Z., Piontek T., Metrick A., The Lehman Brothers Bankruptcy A: Overview, Journal of Financial Crises, Vol. 1, 2019, pp. 39-62.
Wilkins M., The History of the Multinational Enterprise, in A.M. Rugman (ed), The Oxford Handbook of International Business, 2nd edn, OUP, 2009, pp. 3-35.
Wilkins M., The Emergence of Multinational Enterprise: American Business Abroad from the Colonial Era to 1914, HUP, 1970.
Willems M. (ed), Cash Pooling and Insolvency: A Practical Global Handbook, Globe Business Publishing, 2012.
Williams J.F., The Fallacies of Contemporary Fraudulent Transfer Models as Applied to Intercorporate Guaranties: Fraudulent Transfer Law as a Fuzzy System, Cardozo Law Review, Vol. 15, 1994, pp. 1403-1474.
Williamson O.E., Opportunism and its Critics, Managerial and Decision Economics, Vol. 14, 1993, pp. 97-107.
Williamson O.E., The Modern Corporation: Origins, Evolution, Attributes, Journal of Economic Literature, Vol. 19, 1981, pp. 1537-1568.
Wilton J.M., McGee W.A., The Past and Future of Debt Recharacterization, The Business Law, Vol. 74, Winter 2018-2019, pp. 91-125.
Winner M., Group interest in European company law: an overview, Acta Univ. Sapientiae, Leg. Stud., Vol. 5, 2016, pp. 85-96.
Witting C., Liability of Corporate Groups and Networks, CUP, 2018.
Wood P., Corporate, Bank and Sovereign Insolvencies: Why the Difference? Business Law International, Vol. 22, 2021, pp. 307-317.
Wood P., Law and Practice of International Finance, Sweet & Maxwell, 2008.
Wood P., Project Finance, Securitisations, Subordinated Debt, 2nd edn, Sweet & Maxwell, 2007.
Wood P., International Loans, Bonds, Guarantees, Legal Opinions, Sweet & Maxwell, 2007.
Wood P., Principles of International Insolvency, 2nd edn, Sweet & Maxwell, 2007.
Worthington S., Good Faith, Flawed Assets and the Emasculation of the UK Anti-Deprivation Rule, The Modern Law Review, Vol. 75, 2012, pp. 112-121.

Youard R., Default in International Loan Agreements – Part 2, Journal of Business Law, 1986, pp. 378-392.

Zanten T. van, Het lot van de overeenkomst bij insolventie: Stormachtige ontwikkelingen op het snijvlak van het overeenkomsten- en insolventierecht, TvI 2020/49.

Zanten T.T. van, De overeenkomst in het insolventierecht (Recht en Praktijk, nr. InsR3), Deventer, Kluwer 2012.

Zhang D., Preventive Restructuring Frameworks: A Possible Solution for Financially Distressed Multinational Corporate Groups in the EU, EBOR, Vol. 20, 2019, pp. 285-318.

Zorzi A., The Italian Insolvency Law Reform, European Business Law Review, Vol. 32, 2021, pp. 935-964.

Zwieten K. van, Related Party Transactions in Insolvency, in L. Enriques and T.H. Tröger (eds), The Law and Finance of Related Party Transactions, CUP, 2019, pp. 260-282.

Zwieten K. van, Goode on Principles of Corporate Insolvency Law, 5th edn, Sweet & Maxwell, 2018.

Summary

Intra-group financing and enterprise group insolvency: *Problems, principles and solutions*

This book is about intra-group financing, enterprise groups and their interaction with insolvency law. It commences with three narratives that outline the rise and fall of large multinational corporations, namely Lehman Brothers, Nortel Networks and Oi Brazil. Leo Tolstoy famously wrote that "All happy families are alike; each unhappy family is unhappy in its own way" (Anna Karenina, 1878). In the same way, the three insolvency stories are distinct from each other. Yet they also share some notable similarities.

First, multinational firms usually exist as multi-layered structures, comprising dozens or even hundreds of legal entities. This internal complexity frequently results in the multiplicity of insolvency proceedings opened against group members in different countries and subject to different laws. Second, while the companies within the group are legally separate, the group itself might act as an integrated global enterprise. Such integration manifests in the way the group is managed, and in the degree of operational and financial interconnectedness. Preserving group synergies is often vital for maintaining and maximising overall group value. Third, within many groups, financial affairs are coordinated at the group level. It is common for group members to reallocate liquidity (e.g. intra-group loans or centralised cash management) and support each other in obtaining external financing (e.g. cross-guarantees, co-debtorship and provision of collateral). When the group is solvent and there is no default on obligations of its members, these transactions do not pose any problems. By contrast, in financial distress and insolvency, they could lead to protracted disputes and complicate the efficient administration and resolution of group insolvencies.

From early precursors of business groups, such as the Medici system of partnerships in the 15th and 16th centuries, and the European colonial trading empires of the 17th centuries (i.e. the Dutch and English East India Companies), to the emergence of the first modern groups of companies at the end of the 19th century, groups have come to occupy a dominant place in the societies' economic and political life. Yet despite the fact that corporate conglomerates (and not single entities) are the prevailing form of many present-day enterprises, insolvency law has traditionally centred around single entities, and this entity bias largely persists. This conflict between the group economic and legal realities lies at the heart of our analysis.

Considering how diverse groups and their financial arrangements are, we adopt an approach that allows us to look beyond these differences – the principle-based approach. This methodology involves a study of rules and their assessment through the lens of legal principles, all aimed at the development of optimal policy choices. These choices should promote legal principles to the greatest extent. However, legal principles may and often do collide with each other. For example, the principle of protection of legitimate expectations and trust of contractual partners may collide with the principle of estate value preservation and maximisation. The question therefore is: *How should insolvency law be designed to best balance conflicting legal principles in the context of intra-group financing?* To answer this key question, we take interim steps and (i) introduce enterprise groups and their organisational and financial arrangements; (ii) identify legal principles at stake (or in conflict) in the context of intra-group financing and group insolvency; (iii) examine how legislators and courts in different countries decide cases where relevant legal principles are not aligned; and (iv) dissect and analyse the factors that could potentially influence the resolution of conflicts between these legal principles.

Before delving into the content of specific chapters in the book, it is essential to clarify its scope. First, the book is a study of insolvency law. This law is understood broadly to include various proceedings that aim to resolve corporate financial distress. This includes 'traditional' fully collective proceedings designed for the joint satisfaction of all creditors of the debtor company. It also encompasses proceedings that are not premised on or do not require full collectivity (e.g. Dutch WHOA schemes, English schemes of arrangement) and may be available in the absence of insolvency (e.g. US Chapter 11). Second, this book addresses contractual and other voluntary financial arrangements, such as group guarantees, co-debtorships, intra-group loans, and certain contract terms (i.e. intercompany ipso facto and cross-default clauses). Hence, non-contractual or involuntary situations are excluded. Third, our research question and approach necessitate a comprehensive inquiry into and comparison of different national legal systems, along with the ideas and solutions they have developed to tackle similar problems. The primary focus is on three jurisdictions: the USA, the UK and the Netherlands. Fourth, we examine and learn from the post-financial crisis regulation of banking groups. Although this regulation is specific to banks, it might aid us in finding answers to the problems discussed in different chapters of the book. Fifth, and finally, the book does not seek to investigate private international law issues, such as international jurisdiction, applicable law, and the recognition of foreign insolvency proceedings and insolvency-related judgments. It mainly deals with substantive law matters and balances various 'substantive' law principles.

This book is divided into 6 parts and 14 chapters.

Part I. 'Introduction' contains **Chapter 1**, which introduces the reader to the subject, aims and scope of this book. It also sets the scene by presenting three exemplary cases – insolvencies of Lehman Brothers, Nortel Networks and Oi Brazil. These cases vividly illustrate the problems and complexities created by intra-group financing in insolvency.

Part II. 'Enterprise groups: their life and death' provides an overview of corporate groups. **Chapter 2** develops a descriptive account of groups, their common characteristics, and types. It shares historical insights regarding the emergence of modern multinational enterprises and explores one of the most important concepts in company and insolvency law – limited liability. Our goal is to identify the key economic and legal prerequisites for, as well as the facilitators of, the formation of groups. **Chapter 3** describes how insolvency law tackles financial distress within enterprise groups and traces its evolution over time. The Global Financial Crisis of 2008 and the rise of the so-called rescue culture facilitated this evolution and prompted the adoption of group-mindful solutions and tools. The aim of this chapter is both to highlight this progress and demonstrate the limitations of a single enterprise approach.

Part III. 'Principles of insolvency law and how to balance them' establishes a theoretical foundation or methodology for the analysis of intra-group financial arrangements and enterprise group insolvency. **Chapter 4** introduces the principle-based approach, defines a legal principle, and identifies the most relevant legal principles in the context of enterprise group insolvency. **Chapter 5** builds up a conceptual framework embraced for investigating conflicts between these legal principles. The objective of this chapter is to discuss the 'benchmarks' that can be employed to resolve such conflicts. For this purpose, we explore: (i) the notion of fairness, (ii) the relative weight of legal principles, and (iii) meta-principles or fundamental standards, which help resolve conflicts between legal principles, including the meta-principles of proportionality. We conclude that the categories of fairness and weight do not appear to be workable or reliable benchmarks. In contrast, proportionality is universal and can be applied to determine a balanced outcome when legal principles clash in an individual case.

Part IV. 'Intra-group financing and insolvency: transactions and problems' stands as one of the core parts of the book, providing a foundation for evaluation and normative suggestions. It has a dual purpose. First, it describes financial arrangements common within groups of companies. They include, inter alia, cross-guarantees, co-debtorship, intra-group loans, and centralised cash management. Second, it analyses the benefits of intra-group financing for enterprise groups and highlights the problems that such financing and the legal regimes applicable to it can create for efficient group insolvency and restructuring.

Chapter 6 examines a financial arrangement found in most enterprise groups: cross-guarantees. The purpose of this chapter is threefold. First, it delves into the reasons for entering into cross-guarantees and similar liability arrangements, and covers some law & economics explanations, including the agency cost of debt, the impact on firms' access to finance, and levels of risk-taking (i.e. *ex-ante* effects). Second, it highlights and explains how cross-guarantees give rise to various rights and obligations between a principal debtor, a guarantor (or co-guarantors) and a creditor – a configuration we refer to as the 'triangle of rights and liabilities'. The existence and enforceability of these rights and liabilities have direct consequences on the efficiency of restructuring proceedings. Third, it uncovers the problems and challenges that cross-guarantees pose in insolvency (i.e. *ex-post* effects). In the context of insolvency, intra-group guarantees can lead to value destruction due to the simultaneous enforcement of the same debt across the entire group. In this chapter, I identify a specific problem referred to as the 'ricochet problem'. It arises if the guarantor's right to claim compensation from the principal debtor (e.g. through *regres* or an indemnity claim) is not affected by the restructuring proceedings, such as the case in English schemes of arrangement. Filing a ricochet claim by the guarantor against the principal debtor for the full amount could undermine the effectiveness of the restructuring in the first place.

Chapter 7 logically follows the preceding chapter and examines the mechanisms involving the re-allocation of liquidity within an enterprise group. This occurs after financing has been acquired from third parties and is subsequently 'transported' from one group entity to another. This financing can take the form of a single intra-group loan or an on-going re-distribution of funds by way of centralised cash management or cash pooling. The key question here is whether the claims of insiders, such as group members, are and should be subordinated in insolvency. No signs of consensus seem to appear on this divisive issue, either in academic literature or in law. This chapter summarises the arguments in favour and against subordination of insider loans and highlights the most serious critique of subordination related to underinvestment. The latter occurs when economically viable firms are liquidated instead of being rescued.

Chapter 8 focuses on transaction avoidance in insolvency. It raises the question of whether a certain transaction, such a group guarantee, is avoidable in insolvency and whether 'group considerations' play a role in this decision. Based on a comparative analysis, it concludes that in all three jurisdictions cross-guarantees present substantial problems for transaction avoidance law. This is because these transactions are often driven by group considerations or group interest and may not entail clear and direct benefits to guarantors. The chapter puts together the difficulties of *ex-post* substantive review and points out that legal uncertainty is inherent in the assessment of transactions involving group members.

Chapter 9 explores contractual clauses commonly found in financial transactions – clauses that provide creditors with special termination, amendment, or acceleration rights. These are called ipso facto and cross-default clauses. The chapter (i) explains the rationale and operation of ipso facto and cross-default clauses, (ii) highlights their alarming traits and effects on early crisis responses and the resolution of financial distress within enterprise groups, and (iii) discusses how different jurisdictions, including the UK, the USA and the Netherlands, grapple with these contractual provisions in pursuit of a balance between protecting freedom of contract and party autonomy, on the one hand, and ensuring value preservation and efficient restructuring of viable enterprises, on the other hand.

Part V. 'Group sensitive insolvency law: tools and solutions' analyses potential solutions to the problems created by or connected to intra-group financing in insolvency, as outlined in Part IV. It scrutinises various legal tools that have emerged in response to the economic realities of enterprise groups and the patterns of their failures. Such tools include third-party releases, the extension of enforcement stays to non-debtor entities within the group, and the suspension or unenforceability of certain contractual clauses. These tools embrace the so-called 'extension effect'. The 'extension effect' can be seen when certain safeguards or benefits of insolvency law (e.g. a stay) apply to legal entities that are not subject to insolvency proceedings.

The aim of this part is to formulate recommendations or suggestions on how the law can address the challenges of intra-group financing and group insolvencies in a principled, balanced, and proportionate way. Different financial arrangements and unique problems related to them require different solutions. This is why there is no single answer to the main research question, but in fact many answers. These answers are provided in the concluding sections of Chapters 10, 11, 12 and 13. Some of them will be mentioned below.

Chapter 10 discusses group debt deleveraging and debt adjustment by means of third-party releases. The latter present a group-mindful tool, allowing the restructuring of obligations of third parties (e.g. group guarantors, co-debtors, collateral providers) via a single proceeding. Third-party releases have recently attracted heightened attention due to their use in high-profile bankruptcies dealing with mass tort claims, exemplified by cases like Purdue Pharma. This chapter does not touch upon tort cases, instead focusing on transactions related to the attraction of funds by corporate groups. It examines the scope and requirements for releasing third parties (non-debtors) under the laws of the UK, the USA and the Netherlands, and concludes with a summary of main findings and a proposal of elements or considerations, which may guide the design and application of rules on third-party releases. Among these considerations are, for example,

the nature of the release (voluntary vs. involuntary) and the existence of a recourse claim (e.g. indemnity or *regres*), which can be filed by the third party, potentially undermining restructuring efforts. While the economic benefits of third-party releases are clear, it is crucial to use them proportionately and ensure that the rights of creditors are adequately protected (i.e. the 'group best-interest-of-creditors' test).

Chapter 11 focuses on the rules concerning insolvency enforcement stays in the UK, the USA and the Netherlands. It explores whether law permits their extension to non-debtor parties (e.g. group guarantors or co-debtors) who are not themselves subject to insolvency or restructuring proceedings. It makes suggestions on when a group-wide extension of an enforcement stay might be desirable and under what conditions. Extending an insolvency stay may be warranted when an enterprise group is integrated, and the released group member plays an integral and necessary role in the anchor debtor's restructuring or future operations. It may also be justified when the debtor's restructuring plan envisages a third-party release. That said, the extension of a stay to non-debtor parties should be accompanied by adequate protections to prevent potential abuse. This means that the extended stay should be lifted if its continuation harms the creditor.

Chapter 12 is devoted to rescue financing, and specifically to intra-group rescue financing. It is common for struggling companies to find themselves in dire need of cash. Failure to obtain financing may trigger cross-defaults, cause a breakup of commercial ties with critical suppliers, complicating negotiations with creditors and disrupting potential reorganisation. In a group scenario, intra-group financing is further coloured with transaction avoidance and statutory subordination risks, as discussed in the previous chapters. This chapter analyses two strategies that can supplement *ex-post* judicial review: (i) *ex-ante* authorisation of a transaction (so called 'safe harbour'), and (ii) pre-emptive financial arrangements prevalent in banking groups. It concludes with an overview of main findings and suggestions. For example, it contends that a properly structured safe harbour framework for the approval of intra-group rescue financing can be a valuable tool in the group restructuring toolbox. Yet the efficiency of a safe harbour regime will depend on its ability to adequately address group financial distress.

Chapter 13 questions whether the constraints placed by insolvency law on freedom of contract – particularly those concerning the enforceability of ipso facto and cross-default clauses – should be applicable to intercompany ipso facto and cross-default clauses. The purpose of this chapter is twofold. First, it seeks to probe whether law, as adopted in the relevant jurisdictions, allows for extending its protective rules to contracts concluded by debtor's affiliates. Second, from a normative perspective, it examines and makes suggestions on whether and under what circumstances such an extension would be desirable and proportionate. For instance, it is argued that a

group-level extension of insolvency law safeguards may be warranted when the enterprise group is highly integrated, leading to a correlation between the fates and financial positions of group entities. Conversely, extending an ipso facto ban may be less proportionate if a group is decentralised and the insolvency risks of its entities are not correlated.

Part VI. 'Conclusion' comprises the final **Chapter 14**. This chapter summarises the key findings of the book and concludes with some high-level observations and thoughts. It identifies a number of general considerations or factors that tend to play a role in deciding whether a group-mindful approach should be adopted. Without claiming to have discovered all relevant factors, it highlights those which transpire throughout the entire book. These factors include: (i) group integration and interdependence, (ii) the financial situation of non-debtor group entities, (iii) the purpose and nature of the procedure, and (iv) the prevalence of public interest. It is hoped that this book and its findings will contribute to a better understanding of enterprise groups, intra-group financing, and their intersection with insolvency law.

Samenvatting (Summary in Dutch)

Intra-groepsfinanciering en insolventie van groepen van vennootschappen: *Problemen, beginselen en oplossingen*

Financiering, groepen van vennootschappen en het insolventierecht. Het boek begint met de beschrijving van de opkomst en ondergang van drie grote multinationale ondernemingen, te weten Lehman Brothers, Nortel Networks en Oi Brazil. Leo Tolstoy schreef ooit dat "Alle gelukkige gezinnen op elkaar lijken, elk ongelukkig gezin is op zijn eigen manier ongelukkig" (Anna Karenina, 1878). Op dezelfde manier verschillen de drie insolventieverhalen van voornoemde ondernemingen, maar vertonen ze tegelijkertijd opvallende gelijkenissen.

Ten eerste zijn multinationale ondernemingen meestal opgebouwd uit meerdere lagen, bestaande uit tientallen of zelfs honderden juridische entiteiten. In geval van insolventie leidt deze interne complexiteit vaak tot een veelheid aan insolventieprocedures die jegens de afzonderlijke groepsentiteiten worden geopend, doorgaans in verschillende landen en dus beheerst door verschillende rechtsstelsels. Ten tweede kan de groep, hoewel de vennootschappen van de groep juridisch afzonderlijke entiteiten zijn, als een geïntegreerde wereldwijde onderneming optreden. Deze integratie komt tot uiting in de manier waarop de groep wordt bestuurd en in de mate van operationele en financiële onderlinge verbondenheid. Het behoud van groepssynergieën is veelal essentieel voor het behoud en de maximalisatie van de waarde van de groep. Ten derde worden bij veel groepen financiële zaken van verschillende groepsentiteiten op groepsniveau gecoördineerd. Het is gebruikelijk dat groepsentiteiten geld herverdelen (bijvoorbeeld door middel van intragroepleningen of gecentraliseerd kasbeheer) en elkaar ondersteunen bij het aantrekken van externe financiering (bijvoorbeeld door middel van intra-groepgaranties ('*cross-guarantees*'), hoofdelijke schuld ('*co-debtorship*') of verstrekking van onderpand ('*collateral*'). Zolang de groep aan haar verplichtingen blijft voldoen, leiden deze transacties en de daarvoor noodzakelijke rechtshandelingen niet tot problemen. Als zich echter financiële problemen voordoen, of zelfs sprake is van insolventie, kan het behoren tot dezelfde groep leiden tot langdurige rechtszaken en waardevernietiging. Bovendien kan het een efficiënte afhandeling van insolventieprocedures bemoeilijken.

Vanaf de vroege voorlopers van groepen van vennootschappen, zoals het Medici-systeem in Florence van partnerschappen uit de 15e-16e eeuw en de Europese koloniale ondernemingen uit de 17e eeuw (dat wil zeggen, de Nederlandse en Engelse Oost-Indische Compagnieën), tot de opkomst aan het einde van de 19e eeuw van de eerste moderne groepen van bedrijven,

hebben groepen een dominante plaats ingenomen in economie en politiek. Hoewel conglomeraten van vennootschappen – en dus niet individuele vennootschappen – de overheersende vorm zijn van veel hedendaagse ondernemingen, is het insolventierecht traditioneel en voornamelijk gericht op individuele vennootschappen (de zogeheten '*entity bias*'). Dit conflict tussen de economische realiteit enerzijds en de juridische realiteit van groepen anderzijds ligt aan de basis van mijn onderzoek.

Vanwege de diversiteit van groepen en hun financieringsmodel hanteer ik in dit onderzoek een benadering die mij in staat stelt om voorbij eventuele verschillen te kijken: een zogeheten 'beginselbenadering' ('*principle-based approach*'). Deze benadering betreft een juridische bestudering van het recht en analyse daarvan door de lens van juridische beginselen, met als doel optimale beleidskeuzes te ontwikkelen. Deze beleidskeuzes moeten de juridische beginselen zoveel mogelijk bevorderen. Beginselen kunnen echter met elkaar botsen. Het beginsel van bescherming van legitieme verwachtingen en vertrouwen van contractpartijen conflicteert bijvoorbeeld vaak met het beginsel van behoud en maximalisatie van de waarde van insolvente boedels. De vraag is dan ook: *Hoe moet het insolventierecht worden vormgegeven om de conflicterende juridische beginselen in de context van intra-groepsfinanciering in evenwicht te brengen?* Om deze vraag te kunnen beantwoorden, neem ik de volgende tussenstappen: (i) ik introduceer groepen en hun organisatorische en financiële inrichting; (ii) ik identificeer de juridische beginselen die in het geding zijn (of conflicteren) in de context van intra-groepsfinanciering en groepsinsolventie; (iii) ik onderzoek hoe wetgevers en rechters in verschillende landen omgaan met gevallen waarin de relevante juridische beginselen niet met elkaar op één lijn liggen; (iv) ik ontleed en analyseer de factoren die invloed kunnen hebben op het oplossen van een conflict tussen de juridische beginselen.

Alvorens in te gaan op de inhoud van specifieke hoofdstukken, is het belangrijk om de algemene reikwijdte van mijn onderzoek zoals weergegeven in dit boek te verduidelijken. Ten eerste is het boek een studie van het insolventierecht. Dit recht wordt ruim opgevat en omvat verschillende procedures die tot doel hebben financiële moeilijkheden van ondernemingen op te lossen. Het insolventierecht omvat 'traditionele' volledig collectieve procedures die gericht zijn op een zo groot mogelijke voldoening van alle schuldeisers, maar ook procedures die niet zijn gebaseerd op collectiviteit of geen volledige collectiviteit vereisen (bijvoorbeeld de Nederlandse WHOA of de Engelse '*Scheme of Arrangement*'). Daarnaast raakt het insolventierecht procedures die ook buiten insolventie beschikbaar kunnen zijn (bijvoorbeeld de Amerikaanse '*Chapter 11 Procedure*'). Ten tweede behandelt dit boek contractuele en andere 'vrijwillige' financiële constructies zoals intra-groepgaranties, contractuele hoofdelijke aansprakelijkheid, intragroepleningen en bepaalde contractsvoorwaarden (zoals *intercompany ipso facto*- en *cross default*-bepalingen). Niet-contractueel of 'onvrijwillig'

schuldenaarschap bespreek ik niet. Ten derde vereist de onderzoeksvraag een breed onderzoek naar verschillende nationale rechtsstelsels (inclusief een vergelijking daarvan). De focus van dit boek ligt op drie jurisdicties: de Verenigde Staten van Amerika, het Verenigd Koninkrijk en Nederland. Ten vierde zijn banken vaak ook als groep actief op de markt en in de regelgeving voor insolventie van banken is deze problematiek specifiek geregeld. Ik richt mij op de regelgeving voor groepen van banken die is ontwikkeld na de financiële crisis van 2008. Hoewel deze regelgeving specifiek ziet op de bancaire sector, kan zij van nut zijn bij het vinden van oplossingen voor de problemen die ik in de verschillende hoofdstukken van het boek behandel ten aanzien van niet-bancaire ondernemingen. Ten vijfde, tot slot, bevat dit boek geen vraagstukken van internationaal privaatrecht, zoals internationale jurisdictie, toepasselijk recht en erkenning van buitenlandse insolventieprocedures en aan insolventie gerelateerde uitspraken. Gelet op het onderwerp van dit boek richt het zich voornamelijk op materieel recht en betreft het een afweging van uiteenlopende 'materiële' rechtsbeginselen.

Dit boek is verdeeld in 6 delen en 14 hoofdstukken.

Deel I. 'Inleiding' bevat **hoofdstuk 1**, waarin ik het onderwerp, de doelstellingen en de reikwijdte van mijn onderzoek introduceer aan de hand van een bespreking van de casus van Lehman Brothers, Nortel Networks en Oi Brazil. Deze casus illustreren de problemen en moeilijkheden die intragroepsfinanciering in insolventie teweegbrengt.

Deel II. 'Groepen van vennootschappen: hun leven en dood' geeft een overzicht van groepsentiteiten. **Hoofdstuk 2** beschrijft wat een groep is en wat de veelvoorkomende eigenschappen en verschijningsvormen zijn. Het hoofdstuk biedt ook enkele historische inzichten over de opkomst van moderne multinationale ondernemingen en onderzoekt een van de belangrijkste leerstukken in het vennootschaps- en insolventierecht: de beperkte aansprakelijkheid van aandeelhouders. Het doel is het identificeren van de belangrijkste economische en juridische voorwaarden voor de vorming van groepen. **Hoofdstuk 3** beschrijft hoe het insolventierecht omgaat met financiële problemen binnen groepen en de ontwikkeling daarvan door de tijd heen. De wereldwijde financiële crisis van 2008 en de opkomst van de zogeheten 'versterking van het reorganiserend vermogen' van ondernemingen ('*rescue culture*') hebben geleid tot de invoering van regels die op groepen zijn toegesneden in het insolventierecht. Het doel van dit hoofdstuk is om zowel deze ontwikkeling te benadrukken alsook de beperkingen van de 'individuele ondernemingsbenadering' ('*single enterprise approach*') te laten zien.

Deel III. 'Beginselen van insolventierecht en hoe deze in evenwicht te brengen' legt een theoretische basis voor de analyse van intra-groep financiële constructies en de insolventie van een groep (in Deel IV). **Hoofdstuk 4** geef ik het analytisch kader waarin ik de op beginselen gebaseerde

aanpak uitleg, het begrip 'beginsel' definieer en de juridische beginselen die het meest relevant zijn in de context van de insolventie van een ondernemingsgroep identificeer. In **Hoofdstuk 5** ontwikkel ik een conceptueel kader dat ik gebruik om conflicten tussen juridische beginselen op te lossen. Het doel is om 'referentiepunten' te vinden die kunnen worden gebruikt om deze conflicten op te lossen. Hiertoe verken ik: (i) het begrip rechtvaardigheid, (ii) het relatieve gewicht van juridische beginselen en (iii) metabeginselen of fundamentele normen die helpen bij het oplossen van conflicten tussen rechtsbeginselen, inclusief het metabeginsel van proportionaliteit. De categorieën 'rechtvaardigheid' en het 'relatieve gewicht van beginselen' lijken geen betrouwbare referentiepunten te zijn. Proportionaliteit, daarentegen, is universeel en kan in een concreet geval van botsende juridische beginselen worden toegepast om een evenwichtige uitkomst te bereiken.

Deel IV. 'Intra-groepsfinanciering en insolventie: transacties en problemen' vormt een van de kernonderdelen van het boek en biedt een basis voor het normatieve beoordelingskader. Het doel van dit hoofdstuk is tweeledig. Ten eerste beschrijf ik hierin financiële constructies die gebruikelijk zijn bij groepen van vennootschappen, zoals de reeds genoemde intra-groepgaranties, hoofdelijke schuld, intragroepleningen, en gecentraliseerd kasbeheer. Ten tweede analyseer ik in dit hoofdstuk de voordelen van intra-groepsfinanciering voor ondernemingsgroepen en benadruk ik de problemen die dergelijke financiering en de daarop toepasselijke wettelijke regimes kunnen meebrengen voor een efficiënte afwikkeling van insolventie- en herstructureringsprocedures.

In **Hoofdstuk 6** onderzoek ik intra-groepgaranties, omdat die vaak in groepen voorkomen. Het doel van dit hoofdstuk is drieledig. Ten eerste kijk ik naar de redenen om intra-groepgaranties en vergelijkbare aansprakelijkheidsregelingen aan te gaan. Daarbij behandel ik enkele rechtseconomische benaderingen, waaronder de *agency*-kosten van schulden, de invloed van intra-groepgaranties op de toegang van ondernemingen tot financiering en de mate waarin risico's worden genomen (de *ex-ante*-effecten). Ten tweede leg ik uit hoe intra-groepgaranties leiden tot verschillende rechten en verplichtingen tussen de hoofdschuldenaar, de partij die zich garant stelt en de schuldeiser. Ik noem deze relatie een 'driehoek van rechten en verplichtingen'. Het bestaan en de afdwingbaarheid van deze rechten en verplichtingen hebben directe gevolgen voor de efficiëntie van herstructureringsprocedures. Ten derde breng ik de problemen en uitdagingen aan het licht die intra-groepgaranties meebrengen in insolventie (de *ex-post* effecten). In insolventie kunnen intra-groepgaranties aanleiding geven tot waardevernietiging als gevolg van de gelijktijdige uitwinning van dezelfde schuld binnen de hele groep. In dit hoofdstuk identificeer ik het '*ricochet*-probleem'. Dit probleem houdt in dat als een borg instaat voor de schuld van een groepsentiteit, regres neemt op de hoofdschuldenaar, en daardoor de herstructurering van die hoofdschuldenaar vervolgens in gevaar komt.

In **Hoofdstuk 7** onderzoek ik de mechanismen die betrekking hebben op herverdeling van geld binnen een groep, waarbij de ene groepsentiteit financiering van een derde verkrijgt en het geleende geldbedrag vervolgens doorleent aan een andere groepsentiteit. Deze financiering kan de vorm aannemen van een enkele intragroeplening of van een voortdurende herverdeling van geld door gecentraliseerd kasbeheer ('*cash pooling*'). De kernvraag hier is of vorderingen van *insiders* (waaronder groepsentiteiten) zijn achtergesteld, dan wel zouden moeten worden achtergesteld in een insolventieprocedure. Er lijkt nog geen consensus te zijn over dit veelbesproken onderwerp, noch in de academische literatuur, noch in de regelgeving en rechtspraak van de bestudeerde rechtsstelsels. Dit hoofdstuk vat de argumenten voor en tegen achterstelling van *insider*-leningen samen en bespreekt de kritiek op achterstelling in het licht van onderinvestering ('*underinvestment*'). Onderinvestering vindt plaats als economisch levensvatbare bedrijven worden geliquideerd in plaats van gered.

Hoofdstuk 8 richt zich op schuldeisersbenadeling. Hierbij behandel ik de vraag of bepaalde transacties, zoals een groepsgarantie, vernietigbaar kunnen zijn in het geval van insolventie en of 'groepsbelangen' een rol spelen bij de beslissing hierover. Op basis van een rechtsvergelijkende analyse concludeer ik in dit hoofdstuk dat in alle drie de rechtsstelsels intra-groepgaranties aanzienlijke problemen opleveren. Groepsentiteiten stellen zich vaak garant vanwege het groepsbelang, maar dat heeft niet altijd duidelijke en directe voordelen voor de individuele groepsentiteiten die zich garant hebben gesteld. In dit hoofdstuk leg ik uit dat een *ex-post* beoordeling problematisch kan zijn vanwege de onzekerheid *ex-ante* die een dergelijke beoordeling meebrengt.

In **Hoofdstuk 9** onderzoek ik contractuele bepalingen die een schuldeiser bijzondere beëindigings- (*termination*), wijzigings- (*amendment*) of opeisbaarheidsrechten (*acceleration*) geven: *ipso facto*- en *cross default*-bepalingen. Het hoofdstuk (i) legt de werking en ratio van dergelijke bedingen uit, (ii) bespreekt hun problematische gevolgen voor de vroegtijdige respons op en afhandeling van financiële problemen binnen groepen, en (iii) behandelt hoe het Verenigd Koninkrijk, de Verenigde Staten van Amerika en Nederland worstelen met deze contractuele bepalingen. In de kern houdt deze worsteling verband met het streven naar een evenwicht tussen het beschermen van de contractvrijheid en partijautonomie enerzijds, en het waarborgen van waardebehoud en een efficiënte herstructurering van levensvatbare ondernemingen anderzijds.

Deel V. 'Groepsrelevante insolventiewetgeving: juridische instrumenten en oplossingen' analyseert mogelijke oplossingen voor problemen die gerelateerd zijn aan financiering binnen een groep, zoals die zijn uiteengezet in Deel IV. Het onderzoekt verschillende juridische instrumenten die in reactie op die problemen zijn ontstaan. Ze omvatten onder meer

'*third-party releases*', de werking van afkoelingsperiodes binnen de groep en de opschorting of niet-afdwingbaarheid van specifieke contractuele bepalingen. Deze instrumenten omarmen het zogeheten 'uitbreidingseffect' ('*extension effect*'). Het 'uitbreidingseffect' doet zich voor waar insolventierechtelijke voordelen en rechtsfiguren (zoals de afkoelingsperiode) ook worden toegepast op groepsentiteiten die niet aan een insolventieprocedure zijn onderworpen.

Het doel van dit deel is het ontwikkelen van aanbevelingen voor wetgeving, zodat deze de problemen van financiering binnen groepen en groepsinsolventies op een principiële, evenwichtige en proportionele wijze kan aanpakken. De verschillende financiële constructies, en de unieke problemen die daarmee samenhangen, vereisen maatwerk oplossingen. De centrale onderzoeksvraag leidt dan ook niet tot één enkel antwoord, maar juist tot vele. Deze antwoorden behandel ik in de slotparagrafen van de hoofdstukken 10, 11, 12 en 13. Enkele daarvan licht ik hieronder uit.

Hoofdstuk 10 bespreekt schuldvermindering binnen groepen en het aanpassen van de schuldvoorwaarden door middel van een opheffing van aansprakelijkheid van (potentieel) betrokken derden, de *third-party release*. Een *third-party release* is een op de groep gericht instrument dat herstructurering van verplichtingen van derden mogelijk maakt (bijvoorbeeld borgen binnen een groep, hoofdelijk medeschuldenaren en zekerheidsverstrekkers) door gebruik te maken van één herstructureringsprocedure (zoals een WHOA-regeling). Er is veel discussie over de kwijtschelding van schulden van derden vanwege het gebruik ervan in spraakmakende faillissementen, zoals het faillissement van Purdue Pharma in de Verenigde Staten van Amerika. Dit hoofdstuk gaat niet in op gevallen van onrechtmatig handelen, maar richt zich in plaats daarvan op transacties die verband houden met het aantrekken van gelden. Het onderzoek richt zich op de reikwijdte en de vereisten voor *third-party releases* naar het recht van het Verenigd Koninkrijk, de Verenigde Staten van Amerika en Nederland. Het sluit af met bevindingen en overwegingen die kunnen bijdragen aan de ontwikkeling van regels voor *third-party releases*. Tot deze overwegingen behoren bijvoorbeeld de aard van de aansprakelijkheidsopheffing (vrijwillig versus onvrijwillig) en het bestaan van een regresvordering (bijvoorbeeld '*indemnity*' of regres) die door de derde partij kan worden ingediend en als gevolg waarvan de herstructureringsinspanningen kunnen worden ondermijnd. Hoewel de economische voordelen van *third-party releases* duidelijk zijn, is het cruciaal deze proportioneel te gebruiken en de rechten van schuldeisers adequaat te beschermen ('*group best-interest-of-creditors' test*).

Hoofdstuk 11 richt zich op de regels voor afkoelingsperiodes in het Verenigd Koninkrijk, de Verenigde Staten van Amerika en Nederland. In dit hoofdstuk behandel ik de vraag of het in deze jurisdicties mogelijk is de werking van de afkoelingsperiode uit te breiden naar partijen (bijvoorbeeld

groepsgarantstellers of medeschuldenaren), die zelf geen onderdeel zijn van insolventie- of herstructureringsprocedures. Hiertoe doe ik voorstellen over wanneer en onder welke voorwaarden een groepsbrede afkoelingsperiode wenselijk is. Een groepsbrede afkoelingsperiode kan gerechtvaardigd zijn als een ondernemingsgroep is geïntegreerd en het desbetreffende groepslid (dat wil zeggen: een groepslid dat profiteert van de groepsbrede afkoelingsperiode) een belangrijke rol speelt in de herstructurering of de toekomstige activiteiten van de geherstructureerde groepsentiteit. Het kan ook gerechtvaardigd zijn als het akkoord van de schuldenaar een *third-party release* bevat. Dat gezegd hebbende moet de groepsbrede afkoelingsperiode vergezeld gaan van adequate beschermingsmaatregelen om mogelijk misbruik te voorkomen. De groepsbrede afkoelingsperiode moet dan ook worden opgeheven als de voortzetting ervan de schuldeiser(s) schaadt.

Hoofdstuk 12 is gewijd aan nieuwe financiering ('*rescue finance*') en meer specifiek aan nieuwe intra-groepsfinanciering. Een onderneming in financiële moeilijkheden heeft doorgaans dringend behoefte aan geld. Het niet kunnen verkrijgen van financiering kan *cross-defaults* veroorzaken, maar kan ook ertoe leiden dat commerciële banden met essentiële leveranciers worden verbroken of onderhandelingen met schuldeisers over schuldaanpassing worden bemoeilijkt. Een mogelijke herstructurering kan daardoor worden verhinderd. In een groepscontext wordt intra-groepsfinanciering verder gekleurd door het risico van een beroep op de faillissementspauliana of van de achterstelling van vorderingen, zoals besproken in eerdere hoofdstukken. Dit hoofdstuk analyseert twee strategieën die een *ex-post* toetsing door de rechter kunnen aanvullen: (i) de *ex-ante* goedkeuring van een rechtshandeling door de rechter (de zogeheten '*safe harbour*') en (ii) preventieve financiële constructies ('*pre-emptive financial arrangements*') die worden gebruikt in de context van financiële groepen. Ik sluit dit hoofdstuk af met een overzicht van de belangrijkste bevindingen en suggesties. Zo stel ik bijvoorbeeld vast dat een goed gestructureerd *safe harbour*-kader voor de goedkeuring van reddingskrediet binnen de groep een waardevol instrument kan zijn voor groepsherstructurering. De efficiëntie van een *safe harbour*-kader zal echter vooral afhangen van het vermogen adequaat te reageren op de financiële problemen van groep in zwaar weer.

In **Hoofdstuk 13** onderzoek ik of wettelijke beperkingen van de contractsvrijheid – beperkingen met betrekking tot de afdwingbaarheid van *ipso facto* en *cross-default* bepalingen – van toepassing zijn dan wel behoren te zijn op intra-groep *ipso facto*- en *cross-default*-bepalingen. Het doel hiervan is allereerst om te onderzoeken of de wet, zoals geldend in de relevante jurisdicties, de mogelijkheid biedt om beschermende wetsbepalingen uit te breiden naar contracten die zijn gesloten door groepsentiteiten van de schuldenaar. Ten tweede is het doel om, vanuit een normatief perspectief, de omstandigheden waaronder een dergelijke uitbreiding wenselijk en passend zou zijn te onderzoeken en suggesties te doen. Er wordt bijvoorbeeld

aangevoerd dat een uitbreiding van de insolventierechtelijke waarborgen op groepsniveau gerechtvaardigd kan zijn als de ondernemingsgroep sterk geïntegreerd is. Een dergelijke integratie leidt namelijk tot een wederzijdse afhankelijkheid van de groepsleden. Omgekeerd kan het uitbreiden van een *ipso facto*-verbod minder evenredig zijn als een groep gedecentraliseerd is en de insolventierisico's van haar entiteiten niet met elkaar zijn verbonden.

Deel VI. 'Conclusie' bevat **hoofdstuk 14**, waarin ik de belangrijkste bevindingen van het boek samenvat en afsluit met enkele afsluitende observaties en opmerkingen. Daarin noem ik enkele meer algemene overwegingen of factoren die een rol kunnen spelen bij de beslissing al dan niet een groepsgerichte benadering te volgen. Dit hoofdstuk beoogt niet alomvattend te zijn, maar hierin belicht ik veeleer de relevante factoren die eerder in het boek naar voren zijn gekomen. Deze omvatten: (i) de mate waarin de groepsentiteiten intern zijn verbonden (groepsintegratie) en de mate van hun onderlinge afhankelijkheid, (ii) de financiële situatie van groepsentiteiten die niet de schuldenaar zijn in een insolventieprocedure, (iii) het doel en aard van de procedure, en (iv) het algemeen belang. Ik hoop dat dit boek zal bijdragen aan een beter begrip van ondernemingssgroepen, intragroepsfinanciering en de interactie daarvan met het insolventierech

Curriculum Vitae

Ilya Kokorin was born on 29 May 1987 in the small Siberian town of Krasnoyarsk-26, which was later renamed Zheleznogorsk after the collapse of the USSR. He studied law and history at Tomsk State University in Tomsk (Russia), comparative constitutional law at Central European University (Hungary), and civil and commercial law at Leiden University (the Netherlands). In addition to his academic pursuits, he also gained experience in legal practice working at national and international law firms. In March 2017, Ilya came to the Netherlands to work as a lecturer (*docent*) in the department of Company Law (*Ondernemingsrecht*) at Leiden Law School. Over a period of two years, he gave lectures on international insolvency law, comparative corporate law and international commercial law.

In February 2019, Ilya embarked on his academic career as a PhD candidate (*promovendus*) at the Department of Financial Law at Leiden University, under the supervision of Prof. Matthias Haentjens and Prof. Reinout Vriesendorp. This position was funded by the Stichting Hazelhoff Van Huet and the Meijers Research Institute. As a PhD candidate, Ilya was actively involved in teaching and/or coordinating courses on banking and finance transactions, capital markets, and EU financial law. He also supervised the theses of bachelor and master students.

Ilya is an active participant in the Digital Assets Project at the University of Oxford. He is a member of III NextGen, Younger Academics Network of Insolvency Law (YANIL) of INSOL Europe, Young Researchers Group of the European Banking Institute (EBI) and chairs the Early Researcher Academics group at INSOL International. He coaches Leiden University teams in the Ian Fletcher International Insolvency Law Moot and currently holds a position as Assistant Professor (*universitair docent*) at the Department of Financial Law at Leiden University.

In the range of books published by the Meijers Research Institute and Graduate School of Leiden Law School, Leiden University, the following titles were published in 2022 and 2023

MI-382 C.M.F. Mommers, *Voluntary return and the limits of individual responsibility in the EU Returns Directive*, (diss. Leiden), Amsterdam: Ipskamp Printing 2022, ISBN 978 94 6421 583 0

MI-383 M.E. Franke, *Over de grens van de onrechtmatige daad. Een onderzoek naar de plaats van de rechtvaardiging in het buitencontractuele aansprakelijkheidsrecht*, (diss. Leiden), Den Haag: Boom juridisch 2022, ISBN 978 94 6290 152 0

MI-384 B.L. Terpstra, *Instrumental and normative pathways to compliance. Results from field research on moped drivers*, (diss. Leiden), Amsterdam: Ipskamp Printing 2022

MI-385 Q. Mauer, *Application, Adaptation and Rejection. The strategies of Roman jurists in responsa concerning Greek documents*, (diss. Leiden), Den Haag: Boom juridisch 2022, ISBN 978 94 6236 291 8, ISBN 978 90 5189 952 8 (e-book)

MI-386 F. Tan, *The Duty to Investigate in Situations of Armed Conflict. An examination under international humanitarian law, international human rights law, and their interplay*, (diss. Leiden), Amsterdam: Ipskamp Printing 2022

MI-387 G.G. Lodder, *Recht doen of Recht hebben. Een analyse van de rechten van de migrant op bescherming door de staat tegen arbeidsuitbuiting*, (diss. Leiden), Amsterdam: Ipskamp Printing 2022, ISBN 978 94 6421 679 0

MI-388 M. Mannan, *The Emergence of Democratic Firms in the Platform Economy: Drivers, Obstacles and the Path Ahead*, (diss. Leiden), Amsterdam: Ipskamp Printing 2022

MI-389 A.M. Bouland, *'Please Give Me My Divorce'. An Ethnography of Muslim Women and the Law in Senegal*, (diss. Leiden), Amsterdam: Ipskamp Printing 2022

MI-390 B.J. Braak, *Overcoming ruptures: Zande identity, governance, and tradition during cycles of war and displacement in South Sudan and Uganda (2014-9)*, (diss. Leiden), Amsterdam: Ipskamp Printing 2022

MI-391 S.R. Varadan, *Article 5 of the UN Convention on the Rights of the Child. Parental guidance and the evolving capacities of the child*, (diss. Leiden), Amsterdam: Ipskamp Printing 2022, ISBN 978 94 6421 700 1

MI-392 J.M.W. Pool, *De rol van de curator bij de aanpak van onregelmatigheden – Een empirisch-juridisch onderzoek naar de rol van de curator in de praktijk bij de aanpak van onregelmatigheden voor en tijdens faillissement*, (diss.Leiden), Amsterdam: Ipskamp Printing 2022

MI-393 D.S. Verkroost, *'Met zachte drang'. Uitgangspunten voor jeugdhulpverlening op het snijvlak van vrijwilligheid en dwang*, (diss. Leiden), Den Haag: Boom juridisch 2022, ISBN 978 94 6212 735 7, ISBN 978 94 0011 197 4 (e-book)

MI-394 D. Mândrescu, *The application of EU antitrust law to (dominant) online platforms*, (diss. Leiden), Amsterdam: Ipskamp Printing 2022

MI-395 A.H.A. Mohammad, *De normering van academisch ondernemerschap. Perspectieven vanuit het onderwijs(bekostigings)recht, het Europees staatssteunrecht en de academische vrijheid & wetenschappelijke integriteit*, (diss. Leiden), Amsterdam: Ipskamp Printing 2023

MI-396 T.L. Masson-Zwaan, *Widening the Horizons of Outer Space Law*, (diss. Leiden), Amsterdam: Ipskamp Printing 2023, ISBN 978 94 6421 977 7

MI-397 W. Zhang, *Achieving decent work in China. A case study of decent working time*, (diss. Leiden), Amsterdam: Ipskamp Printing 2023

MI-398 T.M. Vergouwen, *The effect of directives within the area of direct taxation on the interpretation and application of tax treaties*, (diss. Leiden), Amsterdam: Ipskamp Printing 2023

MI-399 R. de Massol de Rebetz, *Beyond the Dichotomy between Migrant Smuggling and Human Trafficking. A Belgian Case Study on the Governance of Migrants in Transit*, (diss. Leiden), Amsterdam: Ipskamp Printing 2023

MI-400 W. Ruijs, *Pandbelening*, (diss. Leiden), Den Haag: Boom juridisch 2023, ISBN 978 94 6212 819 4, ISBN 978 94 0011 288 9 (e-book)

MI-401 C. Sriporm, *Franchising Legal Frameworks. A Comparative Study of the DCFR, US Law and Australian Law Regarding Franchise Contracts*, (diss. Leiden), Amsterdam: Ipskamp Printing 2023, ISBN 978 94 6473 088 3

MI-402 N. Amin, State-building, Lawmaking, and Criminal Justice in Afghanistan: *A case study of the prison system's legal mandate, and the rehabilitation programmes in Pul-e-charkhi prison*, (diss. Leiden), Den Haag: Eleven International Publishing 2023, ISBN 978 90 4730 156 1

MI-403 J. Tobing, *The Essence of the 1999-2002 Constitutional Reform in Indonesia: Remaking the Negara Hukum. A Socio-Legal Study*, (diss. Leiden), Amsterdam: Ipskamp Printing 2023

MI-404 W. Zhang, *Protection of aviation security through the establishment of prohibited airspace*, (diss. Leiden), Amsterdam: Ipskamp Printing 2023, ISBN 978 94 6473 103 3

MI-405 A.J. Pasma, *Re-entry support from prison-based and community-based professionals*, (diss. Leiden), Amsterdam: Ipskamp Printing 2023

MI-406 K.R. Filesia, *Speaking the same language. De invoering van de Anglo-Amerikaanse trust in het Nederlandse recht*, (diss. Leiden), Deventer: Kluwer 2023

MI-407 H.A. ten Oever, *Zorginkoopovereenkomst. De rechtsverhouding tussen de zorgverzekeraar en de zorgaanbieder in contractenrechtelijk perspectief*, (diss. Leiden), Den Haag: Boom juridisch 2023, ISBN 978 94 6212 859 0, ISBN 978 94 0011 339 8 (e-book)

MI-408 F.H.K. Theissen, *Sincerely believing in freedom. A Reconstruction and Comparison of The Interpretation of The Freedom of Religion and Belief on The Canadian Supreme Court, The South African Constitutional Court and the European Court of Human Rights*, (diss. Leiden), Amsterdam: Ipskamp Printing 2023, ISBN: 978 94 6473 247 4

MI-409 R.M.S. van Es, *The mind in the courtroom. On forensic mental health reports in judicial decision-making about guilt and sentencing in the Netherlands*, (diss. Leiden) Alblasserdam: Ridderprint 2023

MI-410 I. Kokorin, *Intra-group financing and enterprise group insolvency: Problems, principles and solutions*, (diss. Leiden), Amsterdam: Ipskamp Printing 2023

E.M. MEIJERS INSTITUUT

INSTITUUT VOOR RECHTSWETENSCHAPPELIJK ONDERZOEK

What do Lehman Brothers, Nortel Networks and Oi Brazil have in common, apart from the fact that they were or remain large multinational enterprise groups that faced insolvency at some point? They are characterised by the integrated nature of their business, facilitated through elaborate networks of intercompany financial arrangements. Some of these arrangements 'perforate' limited liability (e.g. cross-guarantees), while others closely tie the fates of separate group members (e.g. intra-group loans, centralised cash management, intercompany cross-defaults). Consequently, the idea of legal separateness, which underpins modern insolvency law, hardly reflects present-day economic realities. This book examines prevalent intra-group financial transactions and explores their influence on and treatment in insolvency within groups of companies. It highlights inherent problems, discusses underlying legal principles, and offers targeted solutions. These solutions are based on a comprehensive analysis of contemporary commercial practices and the legal tools offered by three prominent restructuring jurisdictions: the UK, the USA, and the Netherlands.

The book will be of interest to (i) academics and students studying insolvency law and corporate finance, as it discusses theory and principles of insolvency law, financial transactions and bank resolution, (ii) judges, practicing lawyers and insolvency practitioners, as it describes modern restructuring practices and recent case law from three important restructuring hubs, and (iii) policymakers, as it offers suggestions on how law can be further developed and improved.

This is a volume in the series of the Meijers Research Institute and Graduate School of the Leiden Law School of Leiden University. This study is part of the Law School's research programme 'Coherent Privaatrecht'.