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

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PART I

INTRODUCTION

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

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- 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.

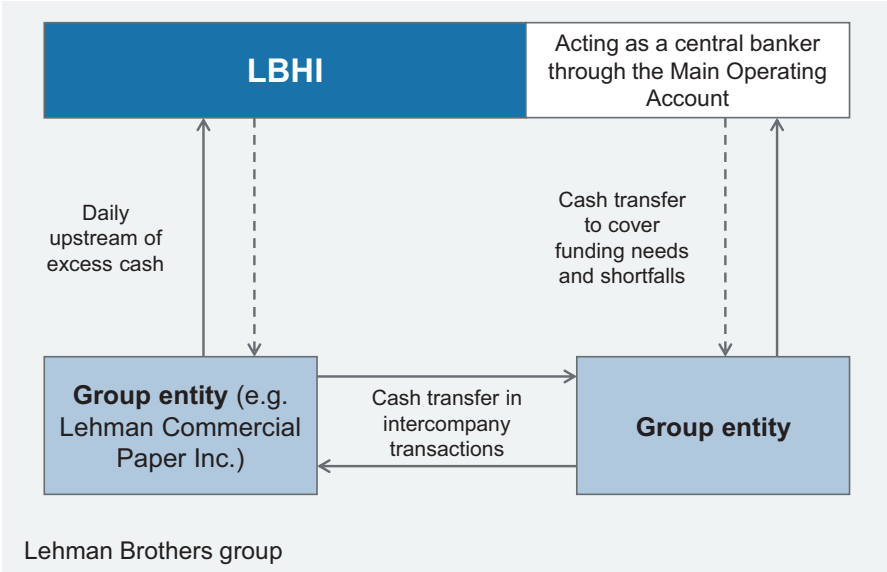


Figure 1. Lehman Brothers cash management system¹⁷

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/jaarsverslagen/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 activities 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 Anel.

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

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- 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 modern 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 arrangement⁷⁵ 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 supra-national 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 as 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) pre-emptive 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, provides 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.