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

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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

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■ 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]

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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-

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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

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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]

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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

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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.

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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.

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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

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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.

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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.