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

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5 Collision of Legal Principles and How to Resolve it■

5.1 Introduction

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

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

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

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

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

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

5.2 The Notion of Fairness in Insolvency Law

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

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

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

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

5 Ibid., para. 109.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

5.3 Weight of Legal Principles

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

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

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

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

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

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

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

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

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

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

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

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

5.4 Meta-Principles

5.4.1 Optimisation: Pareto and Kaldor-Hicks efficiency

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

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

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

34 E. Burg, The Model of Principles. The quest for rationality in the implementation of conflicting principles, Universiteit van Amsterdam, Faculteit der Rechtsgeleerdheid, 2000, p. 175.

35 The principle of efficiency was explained by Vilfredo Pareto in his *Manuel d'économie politique*, Paris, 1909. For discussion, see J. Rawls, A Theory of Justice, Harvard University Press, 1999, p. 58.

36 D. Morrison and C. Anderson, The Australian Corporate Rescue Provisions: How do they Compare? In P. Omar (ed), International Insolvency Law: Reforms and Challenges. Ashgate, Farnham, 2013, p. 196.

and financial stability (e.g. in the case of a financial institution), without damaging the interests of other creditors, whose position is compared to some baseline scenario. However, the following chapters of this book will demonstrate that in insolvency some interests and principles often must give way to other interest and principles. As a result, Pareto efficiency is theoretically possible, but practically unlikely.

An alternative to Pareto efficiency is Kaldor-Hicks efficiency. Kaldor-Hicks efficiency is named after economists Nicholas Kaldor and John Hicks, who formulated it. This type of efficiency approves an outcome that maximises a net gain (total wealth maximisation), even if such an outcome leaves some parties worse off. For example, Kaldor-Hicks efficiency is reached if the aggregate returns to creditors increase, while some creditors of certain group members have to suffer, as long as the benefits to those creditors who are better off exceed the losses of creditors who are worse off, counted in absolute terms. The Kaldor-Hicks efficient outcome is more likely in practice. Yet it could be normatively unattractive because it may encroach on creditors' property rights, pre-insolvency entitlements and legitimate expectations. In theory, creditors who "win" can compensate creditors who "lose", but strictly speaking, this is not required for Kaldor-Hicks efficiency.[37] Besides, it is not clear who should choose the winners and losers and how.

5.4.2 Consistency: alike and unalike cases

Another meta-principle is consistency, which entails the consistent application of legal rules, ensuring that similar cases are resolved in a similar way. Consistency is indispensable for achieving deal certainty and predictability. The similarity aspect relates to both the application of the same principles and the extent of their involvement.[38]

An important side of this meta-principle implies that un-alike cases should be treated in a way that accords to their un-alikeness. While the idea of "treating like cases alike" and accord for differences is appealing, its practical application could face difficulties. For example, consider the provision of intra-group financial support (e.g. an intra-group loan) for restructuring purposes versus financing offered by an external financier to rescue a distressed business. On the one hand, they share similarities as

37 R.A. Posner, Economic Analysis of Law, 8th edn, Aspen Publishers, 2011, p. 17. If such compensation is granted, the outcome is similar to a Pareto-optimal one, since the detriment caused by a group solution to some creditors is remedied. This is why Kaldor-Hicks efficiency is sometimes termed the "potential" Pareto efficiency.

38 E. Burg, The Model of Principles. The quest for rationality in the implementation of conflicting principles, Universiteit van Amsterdam, Faculteit der Rechtsgeleerdheid, 2000, p. 154.

both transactions aim to acquire financing for distressed entities and may be backed by the same principle of value preservation and maximisation. If this holds true, the same rules and priority should apply. On the other hand, the situations are not exactly the same, as one of them involves a related party, which can be treated differently for a valid reason and in a consistent manner. Does this justify denying a related party the protections and privileges available to a non-related party, such as priority or safe harbour? The meta-principle of consistency does not give a definitive answer. So far as a related party is *consistently* treated differently, the requirement of consistency appears to be satisfied.

The main problem of the consistency argument therefore lies in determining "like" and "un-alike" cases. In our view, this initial determination cannot be solely based on the requirement of consistency.

5.4.3 Proportionality: key tool in a balancing exercise

The third meta-principle is proportionality. Proportionality is omnipresent.[39] It regulates the exercise of powers by the European Union,[40] is mandated by the EU Charter on Fundamental Rights,[41] underpins interpretation and application of the European Convention on Human Rights (ECHR) and transpires in many national legal systems.

According to Burg, when applied to a conflict between legal principles, proportionality is achieved if the price (non-realisation of one principle) to be paid for a gain (realisation of a competing principle) is not "out of any reasonable proportion".[42] This may point to a variety of reasonable options or a single answer, assessed from the perspective of a reasonable person.

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39 For discussion of the principle of proportionality, its origins and areas of application, see B. Pirker, Proportionality Analysis and Models of Judicial Review: A Theoretical and Comparative Study, Europa Law Publishing, 2013. See also Y. Arai-Takahashi, Proportionality, in D. Shelton (ed), The Oxford Handbook of International Human Rights Law, OUP, 2013, p. 446, observing that the principle has its origin in Prussian police law of the 18th century, and that it flourished in Germany after the World War II, turning into a shared analytical tool.

40 Treaty on European Union, Article 5: "The use of Union competences is governed by the principles of subsidiarity and proportionality." R. Schütze and T. Tridimas (eds), Oxford Principles of European Union Law. Volume I: The European Union Legal Order, OUP, 2018.

41 Charter of Fundamental Rights of the EU, Article 52: "Subject to the principle of proportionality, limitations may be made only if they are necessary and genuinely meet objectives of general interest recognised by the Union or the need to protect the rights and freedoms of others."

42 E. Burg, The Model of Principles. The quest for rationality in the implementation of conflicting principles, Universiteit van Amsterdam, Faculteit der Rechtsgeleerdheid, 2000, p. 165.

Alexy further breaks down proportionality into three sub-principles: suitability (whether by taking a measure at least one value or a legitimate aim is furthered), necessity (use of the least intrusive means) and proportionality in the narrow sense (balancing requirement).[43] The latter sub-principle states that "[t]he greater the degree of non-satisfaction of, or detriment to, one right or principle, the greater must be the importance of satisfying the other."[44] Its application could be divided into three stages:

(i) determining the degree of non-satisfaction or detriment to one of the principles;
(ii) assessing the importance of satisfying the competing principle; and
(iii) establishing whether the importance of the latter outweighs the detriment or non-satisfaction of the former.

In a similar vein, but in a different (human rights) context, Barak argues that the proportionality test "examines the proper ratio between the benefit stemming from attainment of the object and the deleterious effect upon the human right."[45]

The approach of the ECtHR to proportionality deserves closer examination since it is used to resolve complex situations of conflicting rights and interests. Proportionality analysis plays a key role in the interpretation of the ECHR. As a general rule, an interference with a protected right should have a legal basis – it must be "in accordance with law" or be "prescribed by law",[46] pursue a legitimate aim (e.g. public safety, protection of health and morals), and strike a fair balance between the competing interests. This fair balance entails an application of the prongs of suitability (relationship between the ends and the means) and necessity (the measure should fall within reasonable options available). The court refuses any rigid understanding of suitability and necessity, recognising a certain leeway or "margin of appreciation", enjoyed by the states.

The fair balance test places most of its weight on the stage of the proportionality *stricto sensu*. It represents an open-ended case-by-case weighting exercise, in which it takes into account facts, the degree of interference and

43 R. Alexy, On Balancing and Subsumption. A Structural Comparison, Ratio Juris, Vol. 16, 2003, p. 436. Some authors distinguish four proportionality rules, singling out legitimate ends (whether the act pursues a legitimate end) and suitability (whether the act is capable of achieving this aim). See M. Klatt and M. Meister, The Constitutional Structure of Proportionality, OUP, 2012, p. 8.

44 R. Alexy, A Theory of Constitutional Rights, OUP, 2010, p. 102.

45 A. Barak, Proportional Effect: The Israeli Experience, University of Toronto Law Journal, Vol. 57, 2007, p. 374.

46 *Sunday Times v. United Kingdom*, Appl. no. 6538/74, Judgment, 26 April 1979, para. 45.

whether such interference impairs the essence of the right,[47] as well as conflicting interests and rights. For example, in *Cipolletta v. Italy*, the court ruled that the excessive duration of the Italian "administrative liquidation" procedure (more than 25 years) amounted to a violation of the right to a fair hearing within a reasonable time.[48] In arriving at this decision, the court acknowledged the complexity of insolvency proceedings, especially concerning the identification and collection of the debtor's assets and their sale. And yet it concluded that the excessive length was not justified. Interestingly, in the concurring opinion, Judge Koskelo argued that more emphasis and attention should have been paid to the special nature of insolvency proceedings, which entail a somewhat limited role of courts and involvement of an IP, collective resolution of complex issues arising from financial distress, and the long-term character of measures necessary to achieve the optimal economic results for creditors.[49]

Because of the transpiring nature of proportionality analysis, it can be used to determine a balance in a particular case involving intra-group financing and insolvency. It will be relied upon in our analysis of various legal tools and solutions that are available or can be proposed *de lege ferenda*. Think of the extension of an enforcement stay to non-debtor group companies, acting as guarantors, co-debtors and collateral providers (Chapter 11). First, it should be acknowledged that this extension has a legitimate goal; it promotes the principle of estate value preservation and maximisation (suitability). Second, the extension of a stay should not be automatic and is more justified in integrated groups (necessity). Third, a restraint of enforcement against a non-debtor shall not unfairly prejudice the rights of affected creditors (e.g. guaranteed creditor, creditor benefitting from collateral) or cause any substantial detriment to them (proportionality in the narrow sense). Such detriment may occur when collateral, held by a debtor's group affiliate, significantly depreciates in value during the extended stay.

5.5 Conclusion

This chapter discusses different strategies for resolving conflicts or collisions between legal principles. These conflicts are ineradicable. In fact, it is fair to say that the entire field of insolvency law is about the resolution of conflicting interests created by the financial distress of a debtor or a group of debtors. How should law deal with such conflicts?

47 S. Van Drooghenbroeck, C. Rizcallah, The ECHR and the Essence of Fundamental Rights: Searching for Sugar in Hot Milk? German Law Journal, Vol. 20, 2019, p. 904-923, questioning usefulness of the concepts of the essence, substance, and core of fundamental rights.

48 *Cipolletta v. Italy*, Appl. no. 38259/09, Judgment, 11 January 2019.

49 Ibid., Concurring Opinion of Judge Koskelo, para. 6.

One way is to embrace the notion of fairness and use it to propose outcomes that satisfy this notion to the greatest extent. While any reference to fairness may be appealing, and we generally tend to agree that fair results are desirable, what is fair and what is unfair is hard to determine in the abstract. The answer will depend on the position taken, the issue at stake, parties involved in a dispute and the quality of legal rules. Another way is to accept that legal principles have the dimension of weight or importance, and therefore, a legal principle with greater weight should determine the outcome of a balancing exercise. Again, as with fairness, the weight cannot be assigned to a legal principle in the abstract. It depends on the totality of facts, interests and values. Finally, one can appeal to meta-principles, such as optimisation, consistency and proportionality. Accordingly, rules must be designed and applied optimally, consistently and proportionately. Among the meta-principles, proportionality plays a key role in determining a balanced solution. It occupies a central place in law and "makes it possible to compare and evaluate interests and ideas, values and facts, that are radically different in a way that is both rational and fair."[50]

The proportionality analysis is necessarily case-specific. However, this does not mean that any attempt to dissect some general factors and fact patters which impact the balancing exercise would be futile. But what are these factors and fact patterns? This question points to the anticipated journey that this book invites the reader to take. It goes to the core of what we are seeking to understand, namely when and in which circumstances special group-mindful tools or solutions are balanced and proportionate.

50 D.M. Beatty, The Ultimate Rule of Law, OUP, 2004, p. 169.