12 Intra-group Rescue Financing: Safe Harbours and Pre-emptive Strategies[■]

12.1 Introduction

This chapter should be seen as a response to the concerns raised in Chapter 7 (on the subordination of intra-group claims) and Chapter 8 (on the avoidance of transactions involving group entities). These preceding chapters have shed light on various issues associated with intra-group financing, with two specific problems warranting attention. The first one is the problem of underinvestment which occurs when socially desirable, value-creating projects and rescue attempts do not take place (section 7.5.4.). Insolvency law rules that provide for the avoidance of related-party transactions or the subordination of insider claims can potentially discourage efficient intra-group rescue financing, as they amplify risks for an assisting company (e.g. guarantor, lender, collateral provider). As a result, the principle of estate value preservation and maximisation may be compromised. The second problem relates to the lack of legal certainty concerning the avoidance of transactions common in group financing, such as cross-guarantees and the provision of collateral, in a situation where a guarantor or collateral provider themselves encounter financially difficulties and become insolvent (section 8.3.).

The absence of predictability and sufficient clarity regarding the permissibility of intra-group transfers, whether through intra-group loans, provision of guarantees or collateral, or other transactions, in going concern and gone concern scenarios to manage financial distress and maximise value, is troubling. The key question is how to find a balance between discouraging overinvestment, asset shifting, asset dilution, and other forms of opportunistic behaviour, while at the same time avoiding underinvestment and facilitating the efficient allocation of resources among group entities. This chapter addresses this question.

■ This chapter builds upon the following previously published work by the author:
- I. Kokorin, Preemptive Financing Arrangements within Cross-Border Banking Groups: Between Flexibility and Legal Certainty, in L. Böffel and J. Schürger (eds), Digitalisation, Sustainability, and the Banking and Capital Markets Union, Palgrave Macmillan Cham, 2022, pp. 377-395.
- I. Kokorin, Intra-Group Financial Support in a Crisis: Between Rescue and Abuse, Norton Journal of Bankruptcy Law and Practice, Vol. 29, 2020, pp. 378-420.

There are different strategies that may be adopted to find a balance. This chapter focuses on two such strategies: (i) ex ante authorisation of transactions within a regulated and supervised framework, a safe harbour, as an ad hoc response to financial distress (section 12.2.), and (ii) several pre-emptive financial arrangements commonly used among banking groups (section 12.3). Section 12.4. concludes with our suggestions.

Thus, we examine both private and public law responses to the balancing problem and draw conclusions from developments in corporate insolvency and in the area of bank resolution. The figure below places the discussed strategies along a timeline, reflecting the demise curve or a downward spiral of the company's financial situation. Transaction avoidance rules primarily apply to transactions entered into by the debtor before an insolvency filing, but at a time when the debtor is either insolvent, foreseeably insolvent, or otherwise financially distressed.[1] Hence, ex post judicial review of transactions is situated in the middle column. Ex ante authorisation is available post-filing, whether it is carried out in an insolvency or pre-insolvency procedure (e.g. preventive restructuring framework). It is on the right side of the figure. Finally, preemptive arrangements are established long before insolvency, when the debtor is entirely solvent and liquid. Therefore, they are positioned on the left side of the figure.

Time of transaction	**Pre-filing** No financial distress	**Pre-filing** Financial distress, insolvency or foreseeable insolvency	**Post-filing**
Applicable strategy	Pre-emptive financial and structural arrangements	Ex post review and transaction avoidance	Ex ante authorisation (safe harbour)

Figure 14. Strategies addressing group financial transactions

1 R. Bork, M. Veder, Harmonisation of Transactions Avoidance Laws, 1st edn, Intersentia, 2022, paras. 3.15 and 4.32, explaining that transaction avoidance law commonly addresses transactions concluded or performed prior to the opening of insolvency (liquidation) proceedings. In most legal systems, upon the opening of such proceedings, the rights of disposal and administration over the debtor's estate are shifted to an IP. Transactions occurring after the commencement of insolvency proceedings typically need to be entered into by an IP, with his approval, or the approval by the court.

12.2 Ex Ante Approval Mechanisms and Safe Harbours

12.2.1 Three types of safe harbours

The past years have witnessed the introduction of safe harbour rules into national laws. Before discussing these rules, it is important to clarify the term "safe harbour", as it is used in different contexts and can refer to different things.

First, a safe harbour regime may involve a carve-out of specific types of legal relationships (e.g. certain types of contracts or payments) from otherwise applicable legislation. For example, the US Bankruptcy Code establishes a safe harbour for certain types of financial transactions by granting them immunity from transaction avoidance[2] and insulating them from the prohibition of ipso facto clauses.[3] Similarly, in the UK, the recently introduced limitations on ipso facto clauses do not apply to most financial agreements (e.g. securities contracts, swap agreements, etc.).[4] These carve-outs are introduced to preserve liquidity, instil confidence in financial markets, and mitigate systemic risk.[5]

Second, a safe harbour could encompass the protection of corporate officers from personal insolvency-related liability. An example of such a safe harbour can be found in Australian law, which lays down an exception to insolvency trading liability for directors.[6] This exception applies when a director, in the vicinity of insolvency, engages in "one or more courses of action that are reasonably likely to lead to a better outcome for the company" and "the debt is incurred, or the disposition is made, directly or indirectly in connection with any such course of action."[7] In this context, "a better outcome" means "an outcome that is better for the company than the immediate

2 11 U.S. Code § 546(e). C.W. Mooney Jr., The Bankruptcy Code's Safe Harbors for Settlement Payments and Securities Contracts: When Is Safe Too Safe? Texas International Law Journal, Vol. 49, 2014, pp. 245-269.

3 11 U.S. Code § 555 (securities contracts), § 556 (commodities and forward contracts), § 559 (repos), § 560 (swap agreements).

4 Insolvency Act 1986, section 233B(10), Schedule 4ZZA.

5 Whether bankruptcy carve-outs for financial contracts actually reduce systemic risk remains debatable. See M.J. Roe, Derivatives and repos in bankruptcy, in B.E. Adler (ed), Research Handbook on Corporate Bankruptcy Law, Edward Elgar Publishing, 2020, p. 103, arguing that the carve-outs for derivatives and repos reduce incentives for market discipline, encourage more short-term financing and therefore unfavourably affect financial stability.

6 Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Act 2017. See also Explanatory Memorandum, General outline and financial impact, Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017 (Cth).

7 Corporations Act 2001, sec. 588GA.

appointment of an administrator, or liquidator, of the company."[8] The safe harbour regime in Australia balances creditor protection, discouragement of misconduct, and encouragement of entrepreneurship and restructuring attempts.[9] While not providing absolute legal certainty and predictability, this safe harbour aims to assist directors and those dealing with them to navigate "the legal minefield which surrounds attempts at business rescue."[10] Importantly, however, the Australian safe harbour does not give protection against transaction avoidance actions.[11]

Third, while the first safe harbour exempts certain contracts from the scope of specific rules and the second grants protection to directors of financially distressed companies, the third safe harbour takes the form of an antecedent approval mechanism, establishing screening and ex ante authorisation of transactions.[12] This safe harbour is of particular interest as it can address some of the problems inherent in ex post judicial review, such as hindsight bias and uncertainty of outcomes. A well-structured and cost-efficient ex ante approval regime can promote the principle of protection of trust and certainty of transactions, mitigate information asymmetries, avert opportunistic behaviour, and contribute to the preservation of value by facilitating the provision of rescue financing. In the ensuing paragraphs, we delve into these safe harbours as established in Dutch and US law.

UK law is excluded from our analysis, because it lacks a tailored regime that facilitates rescue financing. Some priority may be granted to financing attracted by an administrator in the course of administration; such financing qualifies as an administrative expense.[13] In a standalone moratorium, priority for rescue financing can result from the provision of a security interest over the debtor's property.[14] However, neither schemes of arrangement, nor restructuring plans or CVAs are supported by a rescue financing regime. Several proposals were put forward with the aim of encouraging

8 Corporations Act 2001, sec. 588GA(7).

9 S. Steele, I. Ramsay and M. Webster, Insolvency law reform in Australia and Singapore: Directors' liability for insolvent trading and wrongful trading, International Insolvency Review, Vol. 28, 2019, pp. 363-391.

10 J. Harris, A. Hargovan, Potential liability for directors during corporate restructuring: comparative perspectives, in in P.J. Omar and J.L.L. Gant (eds), Research Handbook on Corporate Restructuring, Edward Elgar Publishing, 2021, p. 164.

11 Compare with the safe harbour under § 546(e) US Bankruptcy Code, which applies to financial contracts.

12 For a brief overview of safe harbours in Belgian, French, German, Spanish and Italian law, see B. Wessels and S. Madaus (eds), Rescue of Business in Europe: A European Law Institute Instrument, OUP, 2020, pp. 246-250.

13 Insolvency Act 1986, Schedule 1, para. 3, under which an administrator has the "power to raise or borrow money and grant security therefor over the property of the company."

14 Insolvency Act 1986, section A26, under which the debtor may grant security over its property if the monitor gives his consent, which can only be given if the monitor believes the grant of security will support the rescue of the debtor as a going concern.

lenders to provide rescue financing in the UK.[15] They included granting security to new lenders over property already subject to charges, in priority to existing charge holders.[16] These proposals did not receive a positive response.[17] When it comes to rescue finance in the UK, it is pointed out that a market-based response has naturally emerged. If the business is deemed viable, additional funding is typically extended by existing or new credit providers on a consensual basis.[18]

12.2.2 The Netherlands: safe harbour under the WHOA

The third type of safe harbours has recently been incorporated in Dutch law. To make rescue financing more attractive, the Dutch legislator initially considered setting up a safe harbour that would offer protection against transaction avoidance for security rights created in the period between the proposal of a restructuring plan and voting on it.[19] No distinction was made between new and old financing, and no specific safeguards against abuse were included.[20] In the final version of the WHOA, a legal framework for the protection of rescue financing was substantially refined. According to Article 42a Fw (in the version applicable since 1 January 2023),

> The preceding article [Article 42, dealing with transaction avoidance] may not be invoked to annul a legal act performed after the debtor has submitted a declaration to the clerk of the court as meant in Article 370(3) or after the court has appointed a restructuring expert […] if the court, upon the debtor's request, has granted prior approval of that act. The court shall grant the requested approval if, at the time of approval it can reasonably be assumed that:

15 The Cork Committee recommended that if the administration order is discharged "all creditors should revert to the position as it was when the original application was made, subject to the rights of priority of payment to anyone who in the meantime has given money or advanced credit to the administrator, to enable the company's business to be carried on as a going concern." Insolvency Law and Practice: Report of the Review Committee, 1982, para. 514.

16 Insolvency Service, Encouraging Company Rescue – A consultation (London: DTI, June 2009). The Insolvency Service, A Review of the Corporate Insolvency Framework: A Consultation on Options for Reform, May 2016, para. 10.21.

17 Insolvency and Corporate Governance, Government Response, 26 August 2018, pp. 75-77.

18 Ibid. See J. Payne, J. Sarra, Tripping the Light Fantastic: A Comparative Analysis of the European Commission's Proposals for New and Interim Financing of Insolvent Businesses, International Insolvency Review, Vol. 27, 2018, p. 184.

19 Continuity of Enterprises Act II (*Wet Continuïteit Ondernemingen II*), 2014, Article 42a. See F.M.J. Verstijlen, Ondersteunende voorzieningen in de WHOA, TvI 2020/4.

20 F.M.J. Verstijlen, Flankerende voorzieningen in de Wet Homologatie onderhands akkoord ter voorkoming van faillissement, in Preadviezen van de Vereniging Handelsrecht, Uitgeverij Paris, 2017, p. 137, noting the desirability of a more cautious and fine-tuned approach.

a. the performance of a legal act is necessary to:
   1. allow the debtor to continue its business during the preparation of a plan […], or
   2. allow the debtor to prepare the plan […], to put it to the vote, or to have it approved by the court in accordance with Article 384.
b. this legal act would be in the interests of general body of creditors and would not materially prejudice the interests of any individual creditors.

The Explanatory Memorandum to the WHOA clarifies that this article deals with a situation in which an attempt is made to adopt a restructuring plan, and financing is provided in that regard. Such financing should be necessary to sustain the debtor's business during the plan's preparation. Article 42a Fw allows the debtor to petition the court for authorisation to perform a certain act, such as granting a security right necessary to obtain new financing. The debtor can attract new financing during the preparation of a plan and establish security rights for it, without these legal acts being exposed to the risk of avoidance, should the WHOA plan fail and bankruptcy ensue.

In order to obtain court approval: (i) the debtor should initiate the preparation of a restructuring plan and submit the relevant statement to the court; (ii) financing should be essential to ensure the continuity of the debtor's business during restructuring negotiations; and (iii) the legal act in question should benefit the debtor's joint creditors and should not entail any material detriment to any individual creditor. This is typically the case where creditors are likely to be better off under the WHOA plan compared to an alternative (bankruptcy) scenario.[21] Once court approval is secured, the legal act cannot be annulled in future bankruptcy proceedings. Importantly, Article 42a Fw does not make a distinction between external and internal creditors (e.g. group entities), both of which can in principle rely on it.

The operation of Article 42a Fw may be complicated when several group entities are involved in a restructuring attempt. Consider a scenario where one group entity, Company A, obtains financing from the Creditor. As part of this financial arrangement, another group entity, Company B, furnishes a guarantee or collateral to the Creditor. The court presiding over the restructuring of Company A authorises financing under Article 42a Fw. The question is whether the protective shield of the court's approval extends to cover the guarantee and collateral. We argue that this is not the case. Dutch law respects entity separateness.[22] When the court in the proceedings of

21 Rb. Noord-Nederland 26 March 2021, ECLI:NL:RBNNE:2021:1100, r.o. 2.13.

22 Rb. Noord-Holland 19 February 2021, ECLI:NL:RBNHO:2021:1398, *JOR* 2021/101, m.nt. Tollenaar (*Jurlights*). The court observed that "it is questionable whether the law offers the option of offering a plan for several companies in this combined manner. After all, the basic principle is that a separate agreement is offered for each company, in which the individual company identity and separate assets are respected." Separate plans should be submitted for each group entity, except in cases where the restructured debts are covered by the provisions of Article 372 Fw.

Company A assesses whether financing is required to sustain Company A's operations and whether it materially harms the interests of its creditors, it does not have to, and due to practical considerations, cannot evaluate these aspects pertaining to Company B. This is because the latter entity is not subject to the restructuring scheme or the jurisdiction of the court. It is true that Article 372 Fw, discussed in Chapter 10, enables the restructuring of cross-guarantees via a single WHOA plan. However, this article does not deal with transaction avoidance. It only permits a valid (non-annulled) cross-guarantee to be released and contains distinct rules designed to safeguard the interests of a guaranteed creditor.[23]

If the restructuring of Company A fails and Company B enters bankruptcy proceedings, the guarantee and collateral could be subject to the *actio pauliana* challenge by Company B's IP under Article 42 Fw, or, as the case may be, Article 47 Fw. The IP representing Company B may argue that the transactions in question are disadvantageous, since the guarantee has increased the guarantor's liability and the pledged assets are no longer available to its creditors, while all the benefits of the financing were derived by another entity, Company A. Thus, the safe harbour may not give certainty at the moment when the lending decision is made. One might contend that the guarantee itself is covered by the protective shield of Article 42a Fw simply because it is approved by the court as part of the new financing package; the Creditor would not have extended the loan without the guarantee. However, this view is not persuasive as it effectively deprives the guarantor's creditors of the protections conferred by transaction avoidance rules. In other words, it is disproportionate. As noted above, the decision by a judge to approve financing is based on Company A's situation (and that of its creditors), and it does give consideration to the effects on Company B or its creditors, just as the position of the Creditor providing rescue financing is irrelevant for the court's assessment.

This example illustrates the limits of an ex ante approval mechanism within the context of enterprise groups. The reason is that Article 42a Fw, much like Articles 17 and 18 of the EU Restructuring Directive, does not expressly address group restructurings. While the Restructuring Directive mentions that third-party guarantees are covered by financial assistance deserving protection,[24] it does not outline how this can be arranged in practice, especially when the guarantee might adversely affect the guarantor's own creditors. One potential solution can be proposed. The WHOA's flexibility means that it can be used to implement group restructurings. Separate WHOA schemes could be initiated for Company A and Company B. This will enable Article 42a Fw to be invoked for the approval of the loan and the associated guarantee through two parallel yet coordinated WHOA schemes.

23 Dutch Bankruptcy Act, Articles 372 and 384.
24 Restructuring Directive, Recital 66.

In this scenario, the court would be able to consider the implications of the guarantee for Company B's creditors. Consequently, the protection of rescue financing will encompass the whole package of transactions. This also means that the safeguards and requisites contained in Article 42a Fw and other relevant articles of the Dutch Bankruptcy Act will apply to all relevant group members. Admittedly, the opening of separate proceedings is not ideal in view of transaction costs. However, it may be a necessary sacrifice to ensure procedural fairness and substantive protection of creditors' rights.

12.2.3 The USA: DIP financing as a group effort

The special treatment of post-petition or DIP financing in the USA can be traced back to the 19th century large-scale corporate reorganisations, when lenders were afforded special priority for financing reorganisation efforts, often for distressed railroads companies.[25] At that time, loans were used to support businesses during the lengthy restructuring process. Nowadays, DIP financing is considered to be "the most publicized feature of bankruptcy reorganizations."[26] In Chapter 11, it grants a debtor access to the liquidity necessary to finance a restructuring effort, ensuring uninterrupted operating activity and preventing value-depleting piecemeal liquidation. This, among other things, explains the popularity of Chapter 11 among non-US incorporated debtors and their groups.

The rules on DIP financing can be found in §364 of the US Bankruptcy Code. These rules induce new and existing lenders to provide financing to struggling debtors. They do so in several ways with varying degrees of protection and priority, ranging from administrative expense priority to senior secured credit priority. This creates a ladder of priority that courts can authorise if financing cannot be otherwise obtained. The higher the stair (i.e. level of priority), the more demanding the associated conditions become. Without providing a detailed account of the rather complex regulation of DIP financing, it suffices to point out that US law does not make any exceptions related to the composition of rescue financiers. Thus, the benefits of the DIP financing regime are available to insider lenders as well. One recent example illustrating this is the bankruptcy case of LATAM Airlines Group S.A. and some of its group affiliates, in which shareholder DIP financing

25 D.A. Skeel Jr., The Past, Present and Future of Debtor-in-Possession Financing, Cardozo Law Review, Vol. 25, 2004, pp. 1905-1934; D.A. Skeel Jr., Debt's Dominion: A History of Bankruptcy Law in America, Princeton University Press, 2001, p. 48, noting more generally that "the history of corporate reorganization is the history of nineteenth-century railroad failure."

26 G.G. Triantis, A Theory of the Regulation of Debtor-in-Possession Financing, Vanderbilt Law Review, Vol. 46, 1993, p. 901.

was authorised.[27] Nevertheless, despite the fact that the identity of a DIP financier is of lesser importance, courts apply heightened scrutiny when assessing the *bona fides* of transactions involving related parties.[28]

The US approach is quite distinct. Its distinctiveness comes from the practice of group members filing bankruptcy petitions simultaneously to have their cases jointly administered.[29] This "group filing" is made possible by several notable features of US law. First, the US Bankruptcy Code permits a debtor to file for bankruptcy in any bankruptcy court in which a bankruptcy case concerning the debtor's affiliate is pending.[30] This promotes procedural consolidation and enables a single court, or even a single judge, to oversee the restructuring of the entire group. Second, the flexible and COMI-independent jurisdictional criteria to open a Chapter 11 case allow group companies, including foreign affiliates, to implement group restructuring in the USA in a centralised way. There is no requirement that all (or any) group members have their COMI in the USA.[31] Third, Chapter 11 does not mandate material insolvency of a debtor as an entry threshold.[32] As a result, it eliminates the access barrier in the form of the insolvency requirement and thereby permits participation of different group entities, whether solvent or insolvent, in a group reorganisation.[33]

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27 Order Granting Motion to Approve Debtor in Possession Financing, [ECF No. 1091] *In re LATAM Airlines Group S.A.*, No. 20-11254 (JLG) (Bankr. S.D.N.Y. 2020). The DIP financing involved two existing shareholders, Qatar Airways Investments (U.K.) Ltd and Costa Verde Aeronautica S.A., which held appr. 32% of LATAM's stock.

28 *In re Innkeepers USA Tr.*, 442 B.R. 227 (Bankr. S.D.N.Y. 2010); *In re Papercraft Corp.*, 211 B.R. 813 (W.D. Pa. 1997); *Carlson v. Hallinan*, 925 A.2d 506 (Del. Ch. 2006).

29 S.J. Lubben, American Business Bankruptcy: A Primer, Edward Elgar Publishing, 2021, pp. 109-110.

30 28 U.S. Code § 1408(2). The wide range of permissible bankruptcy venue options, resulting in a concentration of bankruptcy cases in a few districts, attracted some criticism. See the Bankruptcy Venue Reform Act of 2021, which seeks to limit the "affiliate-filing rule".

31 For a bankruptcy jurisdiction, "a dollar, a dime, or a peppercorn" of property in the US suffices. *In re Theresa Mctague* (1996) 198 BR 428, 431. A. Walters, United States' bankruptcy jurisdiction over foreign entities: exorbitant or congruent? Journal of Corporate Law Studies, Vol. 17, 2017, pp. 367-404; G. Ray Warner, Conflicting Norms: Impact of the Model Law on Chapter 11's Global Restructuring Role, International Insolvency Review, Vol. 28, 2019, p. 275, calling the US approach to international insolvency jurisdiction and its global reach "aggressive universalist".

32 P. Blumberg et al., Blumberg on Corporate Groups, 2nd edn, Wolters Kluwer, 2021, § 89.03, observing that "[s]olvency of the subsidiary does not present any hurdle to the institution of voluntary proceedings with respect to the subsidiary and therefore does not present any hurdle to subsequent procedural or substantive consolidation with the proceedings of its insolvent parent."

33 *In re General Growth Properties, Inc.*, 409 B.R. 43, 63 (Bankr. S.D.N.Y. 2009), noting that "a judgment on an issue as sensitive and fact-specific as whether to file a Chapter 11 petition can be based in good faith on consideration of the interests of the group as well as the interests of the individual debtor."

The affiliate-filing rule, flexible jurisdictional standards, and the absence of an insolvency requirement, among other factors, have made the USA a preferred destination for restructurings of enterprise groups. Think of enterprises like Aeromexico, Avianca and LATAM. But most importantly for this section, the above features permit DIP financing to be organised and sanctioned at a group level. In fact, it is common for US courts to approve DIP financing provided to the group, where one group entity acts as the borrower, and other members of the group, each subject to its own bankruptcy proceeding, guarantee the borrower's obligations under the DIP financing.[34]

Before exploring a few examples, it is important to highlight an important feature of US law that ensures the effectiveness of DIP orders and safeguards legal certainty. In Chapter 11, a debtor cannot obtain financing outside the ordinary course of business without a court order.[35] Given that it may not always be obvious if something is done in the ordinary course of business, debtors often seek approval of DIP financing as part of a first-day motion package.[36] Another common motion is a request for the approval of cash management systems.[37] Although the law stipulates that a court may authorise DIP financing *after notice and hearing*, when financing is urgently needed for the continued operation of the business or to protect assets, US courts are willing to authorise it without an actual hearing.[38] The degree of the courts' involvement and control over DIP financing and its terms is limited.[39] What is necessary to point out is that pursuant to the US Bankruptcy Code, if the court authorises DIP financing, any reversal or modification of such authorisation on appeal does not affect the validity of any debt so incurred, or of any priority or lien so granted to an entity that extended such credit in good faith.[40] This "enhanced" safe harbour is of utmost importance

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34 *In re Patriot Coal Corp.*, 2012 WL 3728168 (Bankr. S.D.N.Y. 2012); *In re EWGS Intermediary, LLC*, 2013 WL 6978584, at 6 (Bankr. D. Del. 2013), holding that the debtors (group members) have an immediate need to obtain "Post-Petition Financing in order to, among other things, permit the orderly continuation of the operation of their operating businesses, preserve jobs for their employees, maintain vendor support and minimize the disruption of their business operations, manage and preserve the assets of the Debtors' bankruptcy estates […] in order to maximize the recoveries to creditors of the Estates."

35 11 U.S. Code, § 364(b)-(d).

36 Collier on Bankruptcy, 16th edn, 2022, Vol. 10, ¶ 6003.01.

37 *In re Colad Group, Inc.*, 324 B.R. 208, 216-17 (Bankr. W.D.N.Y. 2005).

38 11 U.S. Code § 102(1)(b). *Morlan v. Universal Guar. Life Ins. Co.*, 298 F.3d 609, 618 (7th Cir. 2002), observing that a "notice and a hearing" really means "notice and the opportunity for a hearing".

39 L. Tsioli, Rescue financing under a 'viability spotlight', Journal of Corporate Law Studies, Vol. 22, 2022, p. 851, observing that "the statutory model of DIP financing leaves the court with de facto very little power to restrict excessive creditor control in light of the fear of becoming the one 'stopping the music on a case' […]". The limited involvement of courts makes the role of the creditor's committee (as a watchdog in the DIP process) crucial.

40 11 U.S. Code § 364(e).

for post-petition lenders. It has a practical effect of mooting appeals against orders authorising DIP financing, as long as: (i) the lender or a group of lenders acted in good faith in extending new credit; and (ii) the creditor attempting to challenge the authorisation does not obtain a stay pending an appeal.[41]

An example of a case in which DIP financing was granted at a group level is the restructuring of Babcock and Wilcox Company, Inc. (B&W) and two of its wholly owned subsidiaries. The debtors filed voluntary Chapter 11 petitions, and the court administratively consolidated the cases under Bankruptcy Rule 1015(b). The debtors also submitted a motion seeking authorisation to enter into a post-petition financing arrangement with Citicorp North America, Inc. (CNA). According to this arrangement, the debtors were to receive a USD 300 million revolving line of credit and a letter of credit facility that allowed them to continue doing business. As part of the agreement, CNA would hold a claim against the assets of all the debtors, and this claim would be accorded super-priority administrative expense status. The agreement provided that if any group entity made payments to CNA in excess of the funds actually received by that particular group entity, said entity would acquire a super-priority claim under §364(c)(1) against other debtors, subordinate only to the CNA's claim.

The court approved the DIP financing, finding that it was "necessary to the collective health of the debtors and that all the debtors would benefit from the agreement."[42] This decision was made despite objections of a creditor of one of the group members. This creditor argued that the agreement did not apportion the super-priority administrative expenses based on the amounts actually used by each individual debtor, resulting in de facto substantive consolidation benefitting certain entities and their creditors while disadvantaging others. The court disagreed and concluded that the DIP financing order did not combine the assets or liabilities of the debtors. The group entities effectively acted as guarantors for the post-petition financing. They maintained separate insolvency estates and, as noted above, acquired a super-priority claim against other debtors for any amounts paid to CNA in excess of funds received from it.

41 *In re Revco D.S., Inc.*, 901 F.2d 1359, 1364 (6th Cir. 1990). See, however, *In re Swedeland Dev. Group, Inc.*, 16 F.3d 552, 562 (3d Cir. 1994), noting that "[w]e see no reason why section 364(e) should be understood to protect a lender with respect to money it has not disbursed." Also, Collier on Bankruptcy, 16th edn, 2022, Vol. 3, ¶ 364.08, arguing that in "view of the extraordinary protection provided by section 364(e), the better approach is to protect only the lender's actual reliance interest, and not its expectation interest."

42 *Clyde Bergemann, Inc. v. Babcock & Wilcox Co. (In re Babcock & Wilcox Co.)*, 250 F.3d 955, 957 (5th Cir. 2001).

The B&W group case is interesting because it concerns collective post-petition financing for related debtors in cases that are jointly administered but not substantively consolidated.[43] The DIP financing was authorised for the corporate group, with the DIP financier obtaining full recourse and priority against the assets of its constituent members, regardless of which group entity was the ultimate beneficiary of the DIP financing. Widen notes that the practice of approving DIP financing, pursuant to which the DIP lender receives priority in the consolidated assets of a group of companies "recognizes the corporate group as a single entity post-petition for the purposes of obtaining financing" and "creates the equivalent of an intercompany family of guarantees to protect the DIP lender."[44]

To conclude, ex ante authorisation of rescue financing can be a valuable addition to ex post judicial review. Yet it cannot and should not fully substitute such ex post review, as it plays a crucial role in safeguarding creditors' rights and remains a fallback option. The effectiveness of a safe harbour as a tool to ensure legal certainty, promote intra-group financing in a crisis, and filter and prevent opportunistic and harmful transactions depends on the design and implementation of the safe harbour. As Rodion Raskolnikov from Dostoevsky's Crime and Punishment (1866) points out, "Trifles, trifles are what matter! Why, it's just such trifles that always ruin everything" (in Russian: "*Мелочи, мелочи главное!.. Вот эти-то мелочи и губят всегда и всё*..."). As is often the case, the devil is in the details. This is also true for using a safe harbour within a group context. If a safe does not accurately reflect the group reality, its efficiency may be limited. This is because it could fail to establish a balance between the interests of individual group entities and their creditors.

If restructuring and the attraction of rescue financing constitute a team (group) effort, relevant group entities should be involved in the authorisation process, and creditors of such group entities should be sufficiently protected. Whether this is achievable in practice depends on a variety of factors, from rules on international insolvency jurisdiction (e.g. whether a centralised group solution is possible) to the specific conditions for accessing restructuring or insolvency proceedings (e.g. whether insolvency is a prerequisite). In this respect, the US Bankruptcy Code offers a framework facilitating group restructuring efforts and intra-group DIP financing as their integral part. It has the whole package, including welcoming jurisdictional standards, low bar for entry, procedural consolidation, and the "enhanced" safe harbour resulting from court authorisation of DIP financing.

43 For a similar DIP financing arrangement involving intercompany guarantees, see *In re Solidus Networks, Inc.*, Not Reported in B.R., 2008 WL 8462968 (9th Cir. BAP 2008).

44 W.H. Widen, Prevalence of Substantive Consolidation in Large Bankruptcies from 2000 to 2004: Preliminary Results, American Bankruptcy Institute Law Review, Vol. 14, 2006, p. 57.

12.3 Pre-emptive Financial Arrangements in Banking Groups

12.3.1 Bank resolution: from reaction to pre-emption

The previous sections discussed the strategy of ex ante authorisation of rescue financing, which applies when an entity experiences financial distress and requires access to rescue financing. In other words, it is an ad hoc crisis-triggered strategy. By contrast, after the Global Financial Crisis, the focus of legislators in the EU and other regions shifted from a reactive approach to a pre-emptive and proactive one, especially in the area of bank regulation. Unlike ad hoc strategies, proactive enhancements are devised and implemented when there are no signs of financial distress or insolvency. The rationale behind this anticipatory crisis preparation is rooted in the recognition that no business is immune to insolvency, and that failures are almost inevitable in complex systems.[45] The GFC is exemplary in this respect. It is therefore logical to make systems less complex and limit the negative consequences of their failures. One way to achieve this is through group recovery and resolution planning.

The requirement for banks to adopt recovery or resolution plans, colloquially known as "living wills", was introduced both in the USA[46] and the EU.[47] There are several important reasons for having living wills.[48] First, detailed and up-to-date plans provide resolution and other authorities with the necessary information for efficient monitoring, timely early intervention, and the execution of resolution tools. Second, these plans play an educational and disciplining role, and improve the awareness of banks' own directors about potential problems or weaknesses.[49] As a result, they can serve as warning indicators and catalysts for addressing impediments to the resolvability of a credit institution or a banking group. This might involve the enhancement of the corporate and financial structure of the group, its business lines, and the division of tasks within the group. Third,

45 S.L. Schwarcz, Regulating Complexity in Financial Markets, Washington University Law Review, Vol. 87, 2009, p. 248.

46 Dodd-Frank Act, Section 165(d). US law does not separate recovery and resolution planning.

47 BRRD, Title II. Under the BRRD, recovery plans are drawn up by banks themselves, while resolution plans are prepared by the Single Resolution Board and national resolution authorities. In contrast, under the Dodd-Frank Act, banks must draft resolution plans and submit them to the Federal Reserve Board, the Financial Stability Oversight Council and the Federal Deposit Insurance Corporation.

48 Some scholars remain sceptical of the practical relevance of recovery and resolution planning. S.L. Schwarcz, Beyond Bankruptcy: Resolution as a Macroprudential Regulatory Tool, Notre Dame Law Review, Vol. 94, 2018, p. 719, commenting: "In my many years as a workout and bankruptcy lawyer, I rarely saw a firm's failure that accurately reflected, much less closely resembled, expectations about the firm when it was profitable."

49 M. Ventoruzzo, G. Sandrelli, O Tell Me the Truth about Bail-In: Theory and Practice, Journal of Business, Entrepreneurship & the Law, Vol. 13, 2020, p. 218.

crisis preparation and the disclosure of information in plans can "clarify expectations and strengthen market confidence in the resolution actions of authorities."[50] Fourth, living wills can contribute to simplifying relations and reducing complexity in multi-layered and multi-national banking groups.[51] This complexity is frequently driven by extensive intra-group transactions.[52]

Among other elements, according to EU law, group recovery plans should contain a detailed description of the group's legal and financial structure and an explanation of internal (intra-group) interconnectedness. In particular, this "interconnectedness" covers material intra-group exposures and financial arrangements, such as cross-guarantees, legal interconnectedness arising from material legally binding agreements between group companies, and operational interconnectedness related to the division and centralisation of functions among group entities, which are important for other entities in the group, such as centralised IT functions, treasury functions, risk functions or administrative functions.[53]

The requirement to prepare living wills is not the only tool reflecting a post-GFC shift to pre-emption. This shift is also evident in the way intra-group support and intra-group obligations are (pre-)arranged or (pre-)positioned within banking groups. There are different mechanisms to ensure that sufficient capital and liquidity are available to members of a banking group in a crisis situation. One such mechanism is a group financial support agreement, introduced in the EU by the BRRD. Other preparatory strategies

50 FSB, Public Disclosure on Resolution Planning and Resolvability. Discussion Paper for Public Consultation, June 3, 2019. In the EU, recovery and resolution plans are not publicly available. Yet some information contained therein must be revealed, such as general terms of group financial support agreements. In the USA, resolution plans consist of a private section containing confidential supervisory and proprietary information that is not available to the public, and an open public section.

51 E. Avgouleas, C. Goodhart and D. Schoenmaker, Bank Resolution Plans as a catalyst for global financial reform, Journal of Financial Stability, Vol. 9, 2013, p. 211, attributing the complexity of banking group structures to banks' desire to exploit the benefits of the legal structure (e.g. regulatory and tax arbitrage) and take advantage of the synergies attached to operating as an integrated group (e.g. intra-group transactions).

52 J-H. Binder, Resolution Planning and Structural Bank Reform within the Banking Union, SAFE Working Paper No. 81, 2014, p. 6.

53 Commission Delegated Regulation (EU) 2016/1075 of 23 March 2016 supplementing Directive 2014/59/EU of the European Parliament and of the Council with regard to regulatory technical standards specifying the content of recovery plans, resolution plans and group resolution plans, the minimum criteria that the competent authority is to assess as regards recovery plans and group recovery plans, the conditions for group financial support, the requirements for independent valuers, the contractual recognition of write-down and conversion powers, the procedures and contents of notification requirements and of notice of suspension and the operational functioning of the resolution colleges [2016] OJ L 184/1, Article 7(1)(c).

relate to the pre-positioning of financial resources in subsidiaries and various organisational (structural) and contractual arrangements supporting such pre-positioning. These mechanisms aim to create a predictable and manageable framework for recovery and resolution of banking groups. Whether they achieve this goal is debatable. It suffices to point out that advance planning differentiates them from the ad hoc (authorisation) and ex post (judicial review) strategies explored elsewhere.

12.3.2 Group financial support agreements under the BRRD

Intra-group financing within banking groups is described as "large, volatile and heavily relied upon around the world."[54] Yet during the GFC, many jurisdictions imposed or tightened restrictions on intra-group transfers, thereby limiting the ability of banking groups to optimally re-allocate funds from a group company with excess capital and liquidity to those group entities that needed them.[55] This was attributed to the policy of insulation and geographical ring-fencing, employed by the states to protect local (national) interests (for the case of Icelandic banks, see section 3.4.2.).

The BRRD recognises that the provision of financial support and assistance between entities within a cross-border banking group may face constraints in a situation of a financial crisis.[56] Some restrictions are found in national and EU law (e.g. individual application of liquidity requirements, large exposure limits). These restrictions are designed to prevent crises, mitigate cross-border contagion, reduce intra-group exposures, protect local creditors and other stakeholders. Alongside these restrictions, general transaction avoidance rules, largely unharmonized across the EU, and the risk of director liability create additional, more covert, obstacles for the continuity of intra-group financing, where one of the parties involved in an intra-group support transaction is in the vicinity of insolvency.[57]

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54 D. Reinhardt and S.J. Riddiough, The Two Faces of Cross-Border Banking Flows, IMF Economic Review, Vol. 63, 2015, p. 781.

55 E. Cerutti et al., Bankers Without Borders? Implications of Ring-Fencing for European Cross-Border Banks, in L.L. Ong (ed), A Guide to IMF Stress Testing: Methods and Models, 2014, p. 152; EC, Study on the feasibility of reducing obstacles to the transfer of assets within a cross border banking group during a financial crisis, Final Report, 2010.

56 BRRD, Recital 38.

57 A. Campbell and P. Moffatt, Large scale bank insolvencies and the challenges ahead, in M. Haentjens and B. Wessels (eds), Research Handbook on Crisis Management in the Banking Sector, Edward Elgar Publishing, 2015, p. 64, observing that in the context of banking groups, problems tend to arise "where local transaction avoidance provisions render intra-group transactions (such as those relating to preferential payments, or the transfer of assets at an undervalue and so forth) void."

In 2012, the European Commission recognised the problem and explored various policy responses, ranging from 'no policy change' (baseline scenario) to the introduction of the concept of "group interest" in company laws of EU countries.[58] Another alternative considered was the conclusion of a voluntary agreement on group financial support and its supervisory approval. The results of a public consultation on these options were mixed. It was accepted that the introduction of "group interest" in related-party transactions could undermine limited liability and blur the boundaries between group companies. However, the establishment of a special tool in the form of a voluntary agreement for intra-group financing, referred to as a "pre-emptive transaction", was generally supported.[59] It was noted that such a tool would alleviate concerns regarding directors' liability, minimise the risks of transaction avoidance and increase clarity for transacting parties. In line with this, the BRRD introduced a special framework called "Group Financial Support Agreement" (GFSA).

A GFSA is entered pre-emptively. It does not involve an immediate transfer of funds or the granting a guarantee or collateral. Instead, it could be seen as a commitment or promise to provide support if the conditions for such support are satisfied in the future. This is why a GFSA can only be concluded if the parties (i.e. group companies) do not meet the conditions for early intervention, such as the infringement or likely infringement of prudential or conduct of business requirements.[60] While the GFSA itself should be concluded pre-emptively, the actual provision of support must be carried out in an early intervention scenario. Hence, business-as-usual transfers do not fall within the scope of the BRRD's protective regime for intra-group financial support.[61] We will now delve into the key features of this supranational regime.

First, the rationale behind GFSAs should be clarified. The BRRD recognises the need for a special regulatory framework to ensure financial stability of banking groups.[62] Without it, the rules of national law (e.g. local regulatory requirements for liquidity/capital) may restrict the ability of group entities to support each other in times of financial distress. Consequently, the efficient use of group resources might be prevented. Some group entities may be cash-rich and can serve as a source of funds for other group members,

58 Impact Assessment accompanying the document – Proposal for a Directive establishing a framework for the recovery and resolution of credit institutions and investment firms, SWD(2012) 166 final.

59 Ibid.

60 BRRD, Articles 19(8) and 27(1). EBA, Guidelines on triggers for use of early intervention measures pursuant to Article 27(4) of Directive 2014/59/EU, 2015.

61 BRRD, Article 19(3), stating that a GFSA shall not constitute a prerequisite to provide group financial support to a distressed group entity "on a case-by-case basis and according to the group policies if it does not represent a risk for the whole group."

62 BRRD, Recital 38.

helping them navigate through asymmetric and idiosyncratic shocks. The political side is also important. The GFC uncovered home-host tensions and exposed local ring-fencing, challenging the practice of centralised capital and liquidity management by cross-border banking groups.[63] The existence of a pre-approved support agreement, such as a GFSA, could (in theory) encourage cooperation between competent authorities in a crisis.

Second, once a GFSA is concluded and approved, its execution must not be inhibited by "any legal impediment in national law."[64] This creates a safe harbour against various impediments, including those arising from insolvency-related transaction avoidance.

Third, intra-group support may only be provided if several conditions are satisfied. For instance, there should be a reasonable prospect that the support will redress financial difficulties of the receiving group company.[65] The support should aim to preserve or restore the financial stability of the entire group or any of its members, and must be in the interests of the group member providing support.[66] Importantly, when assessing the interests of the providing entity (i.e. the grantor of financial support), both direct and *indirect* benefits arising from the restoration of financial soundness of the receiving entity and the preservation of group synergies can be taken into account. The EBA acknowledges that indirect benefits are difficult to quantify, for instance, when they concern limiting potential damage to the franchise and reputation that may occur if a group member is allowed to fail.[67] Finally, the liquidity and solvency of the providing entity shall not be compromised as a result of extending support.[68] Therefore, the providing entity should not sacrifice itself and its creditors for the sake of group interests (section 3.5.1.).

Fourth, the procedure for concluding and executing a GFSA is complex.[69] There are in fact two separate procedures or stages. The first stage concerns the approval of a GFSA. It commences with the parent entity submitting an

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

64 BRRD, Article 19(4).

65 BRRD, Article 23(1)(a).

66 BRRD, Article 23(1)(b).

67 EBA, Guidelines specifying the conditions for group financial support under Article 23 of Directive 2014/59/EU, 2015.

68 BRRD, Article 23(1)(e). Yet non-compliance with prudential requirements for capital, liquidity and large exposures can be authorized in exceptional circumstances. See BRRD, Article 23(1)(g).

69 M. Schillig, Resolution and Insolvency of Banks and Financial Institutions, OUP, 2016, p. 191, observing that the process for approving and executing group financial support agreements is "unsuitable to adequately address a crisis situation."

application for the authorisation of the GFSA to the consolidating supervisor.[70] This application is then transmitted to the competent authorities of the entities involved, with a view to reaching a joint decision.[71] If no such decision is reached within four months, the consolidating supervisor must make its own decision on the application. The matter could also be referred to the EBA, which would then make the final decision. Following authorisation, a GFSA needs to be approved by shareholders of the relevant group entities.[72] The second stage pertains to the approval of the actual extension of financial support (e.g. transfer of funds). It includes the decision by the management of both the providing entity and the receiving entity,[73] as well as non-opposition from the competent authorities.[74]

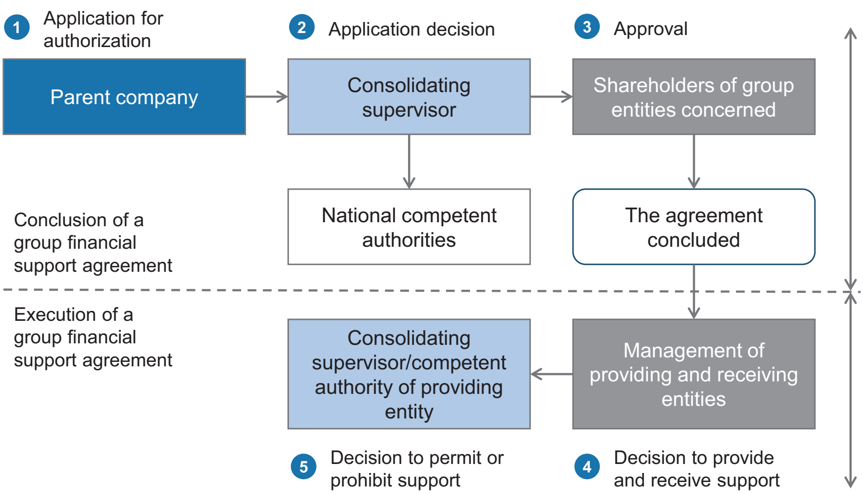

Figure 15. Approval and authorisation of intra-group financial support under the BRRD

To sum up, a GFSA offers a harmonised, relatively clear and transparent framework for intra-group financial support, which could contribute to the optimal allocation of resources within banking groups and ensure the continued operation of banking subsidiaries. However, writing in 2020, approximately five years after the BRRD entered into force, Gardella et al. concluded that the majority of banks active in the EU did not set up a GFSA,

70 The consolidating supervisor is the lead supervisor in the group oversight context. Within the euro area, the ECB is the consolidating supervisor. For a definition, see Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012, Article 4(1)(41).
71 BRRD, Article 20.
72 BRRD, Article 21.
73 BRRD, Article 24.
74 BRRD, Article 25.

as they did not consider it to be a suitable tool.[75] This may be attributed to the complex, cumbersome, and inflexible rules governing the establishment and execution of GFSAs in crisis scenarios. Another drawback of the GFSA regime is that it does not oblige group entities to enter into GFSAs,[76] nor does it mandate their execution or empower supervisory authorities to demand intra-group support if the providing entity is not subject to early intervention.[77] Furthermore, the fact that a GFSA is concluded long before its potential execution can render it less suitable for a given crisis – a time-inconsistency problem.[78]

12.3.3 Prepositioning of loss absorbing capacity within banking groups

To ensure the internalisation of losses in the event of a bank failure and to prevent public bailouts, the BRRD establishes rules on a minimum requirement for own funds and eligible liabilities (MREL).[79] These rules are designed to ensure sufficient loss-absorbing and recapitalisation capacity available in resolution, such that the costs of a failure are borne by the bank's investors (e.g. shareholders and creditors) rather than depositors or taxpayers. The internalisation of losses is an essential pillar of modern bank resolution frameworks. A requirement similar to MREL was developed by the FSB for global systemically important banks (G-SIBs). It is called total loss absorbing capacity or TLAC.[80] Both MREL and TLAC are closely connected to the two prevailing strategies or models of bank resolution: the multiple point of entry model and the single point of entry model.

The MPOE model entails intervention by multiple resolution authorities and the application of resolution measures at the level of operating subsidiaries. This model may be more suitable for banking groups consisting of

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75 A. Gardella, M. Rimarchi and D. Stroppa, Potential regulatory obstacles to cross-border mergers and acquisitions in the EU banking sector, EBA Staff Paper Series No. 7, 2020, p. 28.

76 M. Schillig, Resolution and Insolvency of Banks and Financial Institutions, OUP, 2016, para. 7.50, arguing that this is "a major drawback in the BRRD regime." EBA, Final Report on Recommendation on the coverage of entities in a group recovery plan, 2017, observing that the existence of a group support agreement would certainly help address the situation of financial distress and confirming that it is up to the institution to decide whether to include them as a recovery measure in a recovery plan.

77 D. Ramos Muñoz, M. Lamandini, Evolving key risks in the banking sector and related priorities for the SRB: the lack of an effective transfer-based bank crisis framework, November 2022, p. 9.

78 Time-inconsistency or dynamic inconsistency problem occurs when "the best policy planned currently for some future period is no longer the best when that period arrives." A. Cukierman, Central Bank Strategy, Credibility, and Independence: Theory and Evidence, MIT Press, 1992, p 15.

79 BRRD, Article 45.

80 FSB, Principles on Loss-absorbing and Recapitalisation Capacity of G-SIBs in Resolution. Total Loss-absorbing Capacity (TLAC) Term Sheet, 2015.

operating subsidiaries with limited interconnections to other group companies. Conversely, pursuant to the SPOE model, resolution powers (bail-in, bridge institution tool, etc.) are executed at the level of a holding company at the top of the group or a sub-group (i.e. resolution group).[81] This model is likely to be selected by resolution authorities for centrally structured and operated groups, particularly when material subsidiaries depend on funding from the parent company and the parent company is capable of absorbing losses from its subsidiaries. The gist of the SPOE strategy is to avoid disruption in the activities of group operating subsidiaries and to mitigate the risk of bank runs at the subsidiary level.[82] The BRRD is choice-neutral and equally accepts SPOE and MPOE resolution models.[83] Yet given the level of integration within banking groups in the Banking Union and among G-SIBs, resolution authorities are likely to choose the SPOE model.[84]

To clarify some terms used above, "resolution entities" are group entities to which resolution actions are applied and which are subjects to the rules on "external MREL". Resolution entities, together with their subsidiaries that are not resolution entities, comprise "resolution groups". External MREL refers to debt instruments (mainly bonds) issued by the resolution entity to third parties (non-group persons). In a crisis situation, these third parties suffer losses first. Their claims might be written down or converted into equity as part of a bail-in. Thus, external MREL refers to the external loss absorbing capacity of a banking group. By contrast, "internal MREL" relates to the capacity to up-stream losses from operating subsidiaries to the resolution entity. It requires the issuance (prepositioning) of "loss-absorbing" debt instruments from the former to the latter. These instruments should be capable of being written off if required, allowing losses to be passed to the resolution entity. Viewed from this perspective, internal MREL may be considered a type of intra-group support, because it entails up-streaming of losses from the subsidiary to the parent or resolution entity. The amount of internal pre-positioned MREL should give comfort to local authorities that

81 Directive (EU) 2019/879 of 20 May 2019 amending Directive 2014/59/EU as regards the loss-absorbing and recapitalisation capacity of credit institutions and investment firms (BRRD 2).

82 P.L. Lee, Bankruptcy Alternatives to Title II of the Dodd-Frank Act – Part I, The Banking Law Journal, Vol. 132, 2015, p. 464; J.F. Bovenzi, R.D. Guynn and T.H. Jackson, Too Big to Fail: The Path to a Solution, Economic Policy Program Financial Regulatory Reform Initiative, 2013, pp. 23-32; D.A. Skeel, The new synthesis of bank regulation and bankruptcy in the Dodd-Frank era, in B.E. Adler (ed), Research Handbook on Corporate Bankruptcy Law, Edward Elgar Publishing, 2020, pp. 79-82, discussing benefits and potential problems of the SPOE approach.

83 BRRD, Recital 80.

84 I.A. Fontán et al., Banking Supervision and Resolution in the EU: Effects on Small Host Countries in Central, Eastern and South Eastern Europe, World Bank Group Working Paper, 2019, p. 21, observing that the "SPE is the predominant resolution strategy agreed among resolution authorities for G-SIBs and also for banking groups within the banking union."

adequate resources are available to absorb losses and meet recapitalisation needs of the operating subsidiaries.

There are two potential problems associated with the pre-positioning of internal MREL within banking groups. First, such prepositioning is costly and may restrict the transferability of resources within the group.[85] Second, the prepositioned resources could prove insufficient to cover losses at the subsidiary level and guarantee the uninterrupted operation of subsidiaries. Recapitalisation achieved through the cancellation and/or conversion of debt instruments that meet the conditions for internal MREL does not per se result in the provision of additional funds, which may be necessary to support such uninterrupted operation, especially if banking subsidiaries experience a bank run. The current EU regulatory framework does not impose an obligation on a parent company or resolution entity to extend further support to subsidiaries.[86] Besides, as noted above, national law could limit such support.

12.3.4 Structural and contractual arrangements related to intra-group support

The question is whether an alternative solution can be found to reduce the need for relatively high levels of pre-positioned resources and to secure a pool of readily available resources that can be employed in a flexible manner to address capital shortfalls in different parts of a cross-border banking group. Different tools are embraced to ensure the support of operating subsidiaries and to mitigate the risk that legal, regulatory, or operational barriers impede intra-group transfers. This section discusses relevant structural and contractual arrangements.

Recent amendments to the BRRD (BRRD 2) and the SRMR (SRMR 2)[87] make it possible to substitute the costly option of pre-positioning with the less costly commitment of a top company (resolution entity) to financially assist its subsidiary. Thus, a resolution authority of a subsidiary – a non-resolution entity – can waive internal MREL requirements for that subsidiary under certain conditions. Such a waiver is possible if both the resolution

85 E. König, Single Point of Entry – a resolution strategy addressing the home – host issue in Europe's Banking Union, The SRB Blog, 22 April 2021, commenting that while the BRRD sets a prudent internal MREL requirement, it comes at a price, "as it may lead to the fragmentation of the financial resources of internationally active groups."

86 M. Dewatripont, M. Montigny and G. Nguyen, When trust is not enough: Bank resolution, SPE, Ring-fencing and group support, ECGI Finance Working Paper No. 759/2021, 2021, p. 11.

87 Regulation (EU) 2019/877 of the European Parliament and of the Council of 20 May 2019 amending Regulation (EU) No 806/2014 as regards the loss-absorbing and recapitalisation capacity of credit institutions and investment firms.

entity and its subsidiary are established in the same EU state, if they are part of the same resolution group, and if "there is no current or foreseen material practical or legal impediment to the prompt transfer of funds or repayment of liabilities by the resolution entity to the subsidiary".[88] The law does not clarify what "material practical or legal impediments" are. This lack of clarity has already led to some disputes resolved by the SRB Appeal Panel.[89] Among relevant considerations for the analysis of possible impediments to intra-group transfers, the SRB mentions national company and insolvency laws, the legal structure of the banking group, by-laws and shareholder agreements that may obstruct the transfer of funds or repayment of liabilities by the parent company.[90] A functional substitute to internal MREL is a contractual commitment from the parent company to provide financial assistance to the subsidiary, e.g. via a downstream guarantee.[91] This guarantee is an alternative to the prepositioning of internal MREL, yielding comparable effects. If used, it can offer a degree of flexibility to complement fully prepositioned instruments to meet the internal MREL requirements.

In the USA, contractually binding mechanisms take the form of secured support agreements (SSAs), in which a non-operating holding company, known as intermediate holding company or IHC, assumes an obligation to extend pre-bankruptcy support to material subsidiaries. This support is backed by perfected security interests in collateral granted by the IHC. To enable this arrangement, the IHC is prefunded with resources from a parent company and maintains a liquidity and capital buffer that can be deployed upon a resolution event. The primary objective of this structural setup is to guarantee the uninterrupted going-concern operation of subsidiaries throughout the resolution process. The operation of SSAs aligns with the SPOE model, prevalent among large US banks. This is the result of various regulatory, taxation and accounting policies.[92] SSAs are utilised by many G-SIBs, including Bank of America,[93] Citigroup,[94] JPMorgan Chase & Co,[95] Goldman Sachs,[96]

88 BRRD 2, Article 45f; SRMR 2, Article 12h.

89 SRB Appeal Panel, Final decision, Case 1/2021, 29 June 2022; SRB Appeal Panel, Final decision, Case 2/2021, 27 January 2022; SRB Appeal Panel, Final decision, Case 3/2021, 8 June 2022.

90 SRB, Minimum requirement for own funds and eligible liabilities (MREL), June 2022, Annex II.

91 BRRD 2, Article 45f(5); SRMR 2, Article 12g(3).

92 J. Carmassi and R.J. Herring, The Corporate Complexity of Global Systemically Important Banks, Journal of Financial Services Research, Vol. 49, 2016, p. 175.

93 Bank of America Corporation 2023 Resolution Plan Submission.

94 Citigroup Inc. 2023 Resolution Plan, Public Section, July 1, 2023.

95 JPMorgan Chase & Co, 2023 Resolution Plan Public Filing.

96 The Goldman Sachs Group, Inc. 2023 Resolution Plan, Public Section.

Morgan Stanley[97] and Bank of New York Mellon.[98] All these banks adhere to the SPOE model, which contributes to legal, managerial, and financial centralisation.

For illustrative purposes, the figure below shows the functioning of the Support Agreement, as presented in the resolution plan of JPMorgan Chase & Co. According to it, (i) before the parent company's board votes to file a Chapter 11 petition, the parent company is contractually obliged to downstream certain of its remaining assets to IHC; (ii) IHC undertakes to provide the necessary capital and/or liquidity support to the main bank (JPMCB), and to other key subsidiaries whose pre-positioned resources are insufficient to meet the needs for capital and liquidity in resolution; and (iii) IHC's obligations to provide capital or/and liquidity support are secured by security interest over its assets, so that breach of the secured Support Agreement would give rise to a secured claim based on an agreed-upon damages provision, which would at a minimum be equal to, and could potentially be in excess of, the support obligations. As such, breaching the Support Agreement is meant to cause detriment to IHC.

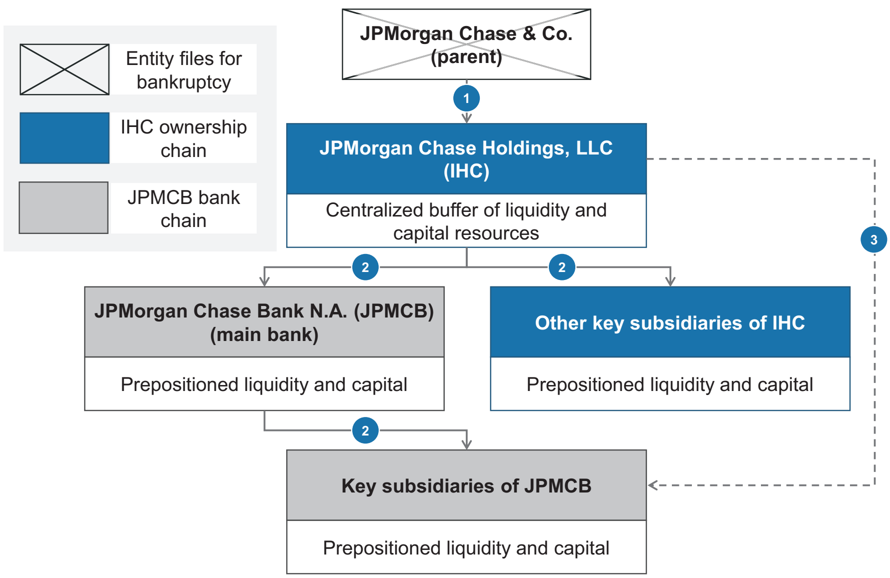

Figure 16. Support agreement under the resolution plan of JPMorgan Chase & Co[99]

97 Morgan Stanley 2023 Resolution Plan, Public Section.

98 BNY Mellon, Resolution Plan, Public Section, 1 July 2023. Interestingly, BNY Mellon used the MPOE model in the 2015 Resolution Plan but opted for the SPOE model in its 2016 resolution plan submission. The same transition to the SPOE model was also made by Wells Fargo in its 2019 plan.

99 This figure is based on JPMorgan Chase & Co, 2023 Targeted Resolution Plan, Public Filing, p. 40.

The legal and operational structure of a banking group and the overall approach to resolution cannot be dealt with in isolation.[100] The SPOE model is preferable when the operations of group entities are integrated and when there is a potential for group-wide contagion. This is common in groups that have centralised corporate and financial structures. For example, in the USA, banking groups historically have a top-level holding company, whose capital structure includes bonds and other long-term unsecured debt, while short-term debt and operations are concentrated in subsidiaries.[101] Conversely, the MPOE model may be more appropriate for decentralised banking groups. Under this model, intra-group support agreements such as SSAs or intercompany guarantees might be less feasible, to the extent that the MPOE model seeks to limit financial interconnections and preserve the separateness of entities in resolution.

Apart from these observations, one should keep in mind that contractual arrangements are intended to complement, rather than replace, the pre-positioning of resources within group entities. They serve to enhance the existing MREL/TLAC regime by introducing flexibility and freeing some resources to be directed where and when they are needed. Arguably, contractual arrangements do not provide the same degree of certainty and predictability as pre-positioned resources. Their effectiveness hinges on two critical assumptions: (i) the availability and sufficiency of resources to be transferred from the parent to its subsidiaries ensuring seamless operations, and (ii) the enforceability of support agreements and their insolvency-proofness. Such enforceability and insolvency-proofness depend on applicable contract and insolvency law.

12.4 Conclusions and Suggestions

12.4.1 Overview of main findings

Regulating financial support within enterprise groups is a difficult task due to the complexity of intra-group relations, the variety of operational and financial arrangements among group members, entity bias in company and insolvency law, and the risk of opportunistic behaviour by group members.

100 D. Schoenmaker, The impact of the legal and operational structures of euro-area banks on their resolvability, Policy Contribution, Issue 23, 2016, p. 6; P. Bolton and M. Oehmke, Bank Resolution and the Structure of Global Banks, The Review of Financial Studies, Vol. 32, 2019, p. 2415, highlighting the need for complementarity between a bank resolution strategy and the structure of global banks.

101 D.A. Skeel, Single Point of Entry and the Bankruptcy Alternative, in M.N. Baily and J.B. Taylor (eds), Across the Great Divide: New Perspectives on the Financial Crisis, Hoover Press, 2014, p. 313, noting that this structure of the US financial groups "is in large part a historical accident, caused by restrictions on banks' ability to branch across state lines and other regulatory obstacles."

The preceding chapters have identified two issues specific to intra-group financing. Chapter 7 explored the effects of the statutory subordination of intra-group loans, while Chapter 8 shed light on the challenges of ex post review of transactions involving group members. Both statutory subordination and transaction avoidance significantly increase the risk for parties extending financing. This chapter discussed two strategies that may be used to facilitate efficient intra-group rescue financing: safe harbours and preemptive structural and contractual arrangements.

English law does not have a well-developed statutory framework promoting rescue financing. In contrast, Dutch and US laws contain rules on ex ante authorisation of rescue financing, applicable in WHOA schemes and Chapter 11 plans. Dutch law permits the court to approve a legal act necessary to sustain the debtor's operations during WHOA plan preparation. Once approved, this act gains immunity from transaction avoidance. However, as we have shown, the court's approval of a legal act, such as a loan to the principal debtor (a scheme company), does not necessarily give protection for any accompanying transaction, such as a guarantee extended by a group member, which itself is not subject to the WHOA scheme. Should such a guarantor subsequently face bankruptcy, the likelihood of the guarantee being contested is considerable (section 8.2.4.). As for US law, the US Bankruptcy Code contains detailed rules on DIP financing, which equally apply to intra-group DIP financing. Yet transactions involving affiliates are subject to heightened scrutiny based on the "entire fairness" standard. Notably, US courts allow DIP financing to be organised and sanctioned at a group level. Typically, this occurs when group companies file bankruptcy petitions "in one go" and request the court to issue a first-day order approving DIP financing for the entire group, at least on a preliminary basis.

The second part of this chapter analysed various crisis preparation and pre-emption strategies. These strategies mainly apply to banking groups, as banks are subject to specific prudential and resolution requirements, including obligations related to the pre-positioning of resources and liabilities in group entities (i.e. external and internal MREL/TLAC). The need to promote efficient allocation of capital and liquidity within a banking group has led to a plethora of tools and strategies, ranging from a detailed framework for group financial support agreements (GFSAs) laid down in the BRRD, to structural and contractual arrangements affecting intra-group financing. The latter include the establishment of "buffer" intermediate holding companies, intra-group guarantees, and secured support agreements. These pre-emptive strategies reflect two, at times conflicting, perspectives. One perspective facilitates the integrated management of capital and liquidity in the banking group, allowing the group to allocate resources where they are most needed. This is the perspective of "flexibility and efficiency" of intra-group financing, better served by *contractual* support arrangements. These are very common among large US banks. Yet questions remain about their effectiveness and enforceability during a crisis. Another perspective prioritizes “legal certainty and predictability”. It is promoted by prepositioning, wherein resources are locked up in separate group entities. While facilitating resolvability, ensuring certainty and enhancing protection of national financial interests, it may freeze resources that could otherwise be freely used elsewhere in the group. When choosing between these two perspectives, one is effectively navigating between Scylla and Charybdis.

12.4.2 Suggestions on dealing with intra-group rescue financing

Based on an overview of different approaches to intra-group rescue financing and building on our findings outlined above and in Chapters 7 and 8, the following suggestions are offered regarding intra-group recue financing in an insolvency context.

First, when applying transaction avoidance rules to transactions involving group members, such as cross-guarantees, and specifically when determining the associated benefits and detriments of any given transaction, group considerations and group interest must be taken into account. This group-conscious application of the law is necessarily fact-intensive and involves the assessment of different characteristics of an enterprise group and its financial distress. Some factors that may be considered include:
- group integration and interconnectedness;
- the allocation of roles and functions among companies within the group;
- the presence of other guarantors and *in rem* security interests, which can benefit the guarantor and reduce its risks (e.g. due to subrogation or indemnity claims);
- the economic viability of an entity receiving financial support;
- external and internal causes contributing to financial difficulties;
- current market conditions and potential adverse trends; and
- the likely consequences of extending and withholding financial support.

When reviewing these factors, it is important to bear in mind that group interest alone cannot warrant the deprivation or sacrifice of the rights and interests of creditors of individual group members (section 3.5.2.).

Second, even if group considerations are integrated into the analysis and facilitate efficient intra-group financing, thereby promoting the principle of (group) value maximisation, they cannot eliminate the legal uncertainty inherent in ex post judicial review. The greater the complexity of the legal assessment and the number of factors involved, the more scope there is for judicial discretion. To promote the principle of protection of legitimate expectations and trust (section 4.3.2.), a strategy of ex ante authorisation of legal acts may be embraced. Once authorised, a legal act (e.g. an intra-group loan or a cross-guarantee securing it) is shielded from future avoidance actions. This legal act falls within a “safe harbour”. If so prescribed, the authorisation can also “deactivate” statutory subordination or even confer priority to rescue financing.

When designing a safe harbour, different rules should be formulated for financing necessary to continue the debtor’s operations during negotiations with creditors (i.e. interim financing) and for financing required to implement a restructuring plan (i.e. new financing). While for interim financing, due to its urgency, the decision-making power could be vested in the court, the approval of new financing should be primarily left to the affected creditors. This is because these creditors are the ultimate risk-bearers. In other words, they have “skin in the game” and stand to incur losses if the (group) restructuring fails. Moreover, in a situation of uncertainty, the decision theory suggests that a collective decision made by a large and diverse group of persons like creditors is preferred to a decision made by a single expert, such as a judge.[102]

In their recent book, Bork and Veder are critical of both restructuring privileges and ex ante authorisation of transactions.[103] Their critique primarily revolves around two key points.

First, Bork and Veder observe that in view of the rescue financier’s awareness of the debtor’s substantive insolvency, which is interpreted to include likely insolvency at some point in the future, the principle of protection of trust and legitimate expectations of creditors is triggered to a lesser degree, if at all.[104] While it is true that the existence of the risk itself is foreseeable and undisputed, determining its extent could be challenging. We note that the awareness of the debtor’s financial distress or prospective insolvency, or the fact that the counterparty is another group member, do not make creditor expectations less legitimate. The predicament lies in legal uncertainty and increased credit risk. The main question is how to deal with such uncertainty and risk to encourage *efficient* rescue financing. We are of the opinion that the absence of ex ante authorisation might lead to foregone rescue attempts (the problem of underinvestment, see section 7.5.4.) to the detriment of estate value maximisation.

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102 S. Madaus, On decision-making in rescue cases: why creditors and shareholders should decide about a rescue plan, in B. Santen and D. van Offeren (eds), Perspectives on international insolvency law: A tribute to Bob Wessels, Kluwer: Deventer, 2014, pp. 215-227. The decisive role of creditors in decisions concerning rescue financing is supported by Tsioli. See L. Tsioli, Rescue financing under a ‘viability spotlight’, Journal of Corporate Law Studies, Vol. 22, 2022, p. 876, arguing for an approach in which “terms of the rescue financing would have to be considered by the entirety of the debtor’s creditors in a process that imitates the ‘give-and-take’ bargaining dynamics of the market-based model of rescue financing, albeit within an otherwise statutorily-organised framework.”

103 R. Bork and M. Veder, Harmonisation of Transactions Avoidance Laws, 1st edn, Intersentia, 2022, paras. 4.119-4.122.

104 Ibid., para. 4.121.

Second, Bork and Veder question how any ex ante control of rescue financing is capable of incorporating the assessment of avoidance prerequisites at a later point in time.[105] Arguably, this critique may be less persuasive for interim financing, which aims to ensure the continuity of business operations during restructuring negotiations. In any event, one should weigh the anticipated benefits of rescue financing against potential detriments. The benefits have to be evaluated at the time of court authorisation, rather than when the rescue effort fails, if it does at some point in the future. Given the uncertainty of the future, establishing legal certainty via court or creditor approval may be the only means to secure rescue financing here and now.

We believe that a properly structured safe harbour for rescue financing can be a valuable tool in the group restructuring toolbox. Ex ante authorisation within a controlled and supervised process is suitable, necessary, and proportionate. The vast experience related to DIP financing in the US and a limited number of Dutch WHOA schemes support this conclusion. A statutory framework that promotes rescue financing can be particularly useful in jurisdictions without a developed rescue financing market. In these jurisdictions, the market could fail to seize the opportunity and invest in a viable business (market failure) unless it is supported by statutory intervention.

Third, the efficiency of a safe harbour regime will depend on its ability to adequately address group financial distress. Focusing solely on an individual entity within a group (e.g. an entity seeking rescue financing) is unlikely to capture the whole picture.

If reorganisation is a collaborative "group effort" and several group members are involved in securing rescue financing by acting as guarantors, co-borrowers or collateral providers, then all intra-group financial support transactions should ideally be included in a safe harbour. In the case of such an "extended" safe harbour, it is crucial to ensure that the rights and interests of creditors of the group entities involved are protected. In our view, this approach is balanced and proportionate as it: (i) fosters efficient value-preserving and value-enhancing rescue attempts, tackling underinvestment and contributing to value preservation and maximisation; (ii) ensures legal certainty and protection of trust; (iii) guarantees the finality and prevents protracted litigation, thereby facilitating procedural efficiency and cost saving; and (iv) when coupled with prior notice and a court hearing or a creditor vote on the proposed financial package, ensures procedural fairness (see section 5.2.) and offers safeguards against group opportunism, including asset stripping and gambling for resurrection.

105 Ibid., para. 4.122.

Fourth, this chapter demonstrates the challenges of balancing flexibility and legal certainty in the context of intra-group financial support within banking groups. This is an area where supranational rules (e.g. BRRD, SRMR) co-exist with national corporate, contract, and insolvency laws, but also where various political issues are at stake (home/host debate). As a result, there may be multiple obstacles and uncertainties surrounding intra-group transfers. To achieve deeper integration of the European banking sector and facilitate efficient management of resources (capital and liquidity) within banking groups, we advocate for the establishment of a bespoke, harmonised, predictable, cost-efficient and legally binding mechanism for intra-group transfers in the EU. This mechanism could draw inspiration from the existing framework for GFSAs and can bring clarity and efficiency to intra-group financing within banking groups.[106] It will reinforce trust, legal certainty, and credibility, all of which are essential for any effective cross-border resolution regime.

When it comes to non-financial enterprises, certain pre-emptive strategies common in banking groups are worth considering and learning from. These strategies include the preparation of group recovery plans, the allocation (prepositioning) of resources to key group companies and entering into group support agreements to ensure financing of these key companies in a stress situation. Pre-emptive strategies are particularly relevant and proportionate for significant non-financial enterprises (SNFEs) – companies and enterprise groups whose failure can produce significant negative social and economic externalities, affecting a large number of people and businesses, leading to increased state expenditures, bailouts, and potentially disrupting vital public services.[107] Notable examples include the bankruptcies of Chrysler and General Motors in 2009, or more recent liquidations of Carillion and British Steel. For such SNFEs, both increased state intervention and a shift from reactive, ad hoc responses to proactive measures, preparation and pre-emption are entirely justified.[108]

106 I. Kokorin, Preemptive Financing Arrangements within Cross-Border Banking Groups: Between Flexibility and Legal Certainty, in L. Böffel and J. Schürger (eds), Digitalisation, Sustainability, and the Banking and Capital Markets Union, Palgrave Macmillan Cham, 2022, pp. 377-395. Creation of such a legal regime is also supported by D. Ramos Muñoz, M. Lamandini, Evolving key risks in the banking sector and related priorities for the SRB: the lack of an effective transfer-based bank crisis framework, November 2022, p. 16.

107 P. van Asperen, H. Koster, Leveranciers van elektriciteit en warmte in financiële moeilijkheden: een verkenning van de wettelijke regelingen, *O&F* 2020-4, p. 70-93.

108 For a discussion on the application of bank resolution-inspired tools to significant non-financial enterprises, see I. Kokorin, Insolvency of Significant Non-Financial Enterprises: Lessons from Bank Failures and Bank Resolution, European Business Law Review, Vol. 32, 2021, pp. 521-556.