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

Kokorin, I.

# Part VI

# Conclusion

# 14 Key Findings and Observations

## 14.1 Forces of Change and Group Insolvencies

Writing in 2009 on the subject of insolvencies within multinational enterprise groups, Mevorach emphasised that "thus far, legal regimes have refrained from explicitly tackling the problem [of group insolvencies]."[1] However, she pointed out that the "winds of change" were blowing – primarily referring to the work undertaken by UNCITRAL Working Group V on the topic of groups. Such winds could impact the prevailing views and approaches to handling insolvencies of corporate groups. She was right. Since 2009, various initiatives have emerged aiming to modernise insolvency law to ensure the effective and efficient administration of insolvency proceedings in the context of enterprise groups. In **Chapter 3**, this new phase was referred to as the third generation of insolvency law – insolvency law 3.0. It was preceded by two generations when there were no rules targeting group failures and cross-border insolvencies (insolvency law 1.0.), and when some rules appeared addressing international insolvencies but generally on a single-entity basis (insolvency law 2.0.).

Insolvency law 3.0. is represented by such instruments as the WHOA, StaRUG and IRDA schemes (national level), the BRRD and the EIR Recast (regional, European level), and the FSB Key Attributes and MLEGI (international level). Notably, all these instruments were adopted within the span of single decade. This represents perhaps the fastest and most spectacular progress of insolvency law in history, at least of its domain dealing with the insolvencies of enterprise groups. We believe that insolvency law 3.0. is the result of two major forces of change.

The global financial crisis and the proliferation of the so-called "rescue culture" over the past decade have facilitated the realisation and recognition that many global enterprises "live" as groups of interconnected and interdepended (yet legally separate) companies – a group reality. When these enterprises "die", the group reality should be recognised as well. Failure to do so might threaten financial stability, especially in the case of banking groups, or lead to a significant loss of value due to a breakup of important intra-group ties and the destruction of group synergies. The cases of Lehman Brothers, Nortel Networks and Oi Brazil, with which this book

1 I. Mevorach, Insolvency within Multinational Enterprise Groups, OUP, 2009, p. 326.

started, clearly illustrate this point. They uncover the complexities of resolving financial distress within the multi-layered and international structures of groups of companies.

These complexities arise, inter alia, from the ways groups arrange financing both externally and internally. Financing from third parties, such as bondholders and credit institutions, is typically accompanied by cross-guarantees, co-debtorship and collateral arrangements, as well as specific types of contractual clauses that create a correlation between entities within the group, namely intercompany ipso facto and cross-default clauses. In turn, once funds are available to a group entity, they can be transferred internally through intra-group loans and centralised cash management. While a corporate group is solvent and there is no default on obligations, these arrangements usually do not pose any problems. In contrast, in insolvency, they may result in disputes over the validity of pre-insolvency intra-group transfers (Oi Brazil), the calculation, attribution and enforcement of intercompany claims (Lehman Brothers, Nortel Networks, Oi Brazil), access to funds and valuable commercial information (Lehman Brothers), the treatment of cross-guarantees for the purposes of value allocation and distribution (Nortel Networks), and the threat of substantive consolidation which eliminates intercompany claims (Lehman Brothers, Nortel Networks, Oi Brazil). Thus, both intra-group liability arrangements and the challenges they create in a situation of financial distress and insolvency are ubiquitous.

The question of how group reality, recognised as a unique set of legal, economic, and social norms and facts, brought into the spotlight by the forces of change, can be reconciled with the treatment of group-specific financial arrangements in insolvency, is part of the puzzle that this book sought to resolve. It offers an overview and analysis of intra-group financial arrangements within the context of group insolvencies from the perspective of legal principles.

## 14.2 Revealing the Trunk and Branches behind the Leaves

Conducting research in the area of enterprise groups is a dangerous endeavour. The difficulty stems from the fact that enterprise groups are very different from each other. These differences concern economic, financial, operational and managerial structures. Furthermore, from a legal standpoint, there is no consistent or uniform definition of a corporate group. Such definition varies across jurisdictions and between different contexts and areas of law (section 2.3.). **Chapter 2** shows that some groups take the form of integrated pyramid-shaped enterprises with centralised management, while others lack hierarchical patterns and instead operate in a more heterarchical way, distinguished by decentralised and flatter corporate networks with largely autonomous and self-sustaining units (section 2.4.).

This diversity of corporate and operational structures, group financing, management and ownership patterns complicates or makes it impossible to develop a one-size-fits-all approach to their regulation, including regulation in a situation of financial distress and insolvency. What is appropriate for one group of companies might be inadequate, unnecessary, or even harmful to another corporate group and the creditors of its constituent members.

Given how broad-ranging groups and their financial arrangements are, this book adopts an approach that allows us to look beyond their differences and explore shared characteristics, problems and solutions – the principle-based approach. If we were to envision the subject of this book as a tree, the abundance of rules applicable to intra-group financial arrangements would symbolise the leaves on this tree.[2] When the tree is in full foliage, its leaves hide the trunk and the branches supporting them. The trunk is formed by legal principles, such as equal treatment of creditors, estate value preservation and maximisation, protection of legitimate expectations and party autonomy (**Chapter 4**). These principles are fundamental standards that underlie the rules. While the core of the legal principles is not affected in a group insolvency scenario, their application and balancing have to be re-adjusted to accommodate social, economic and legal realities (section 4.4.).

Continuing with the tree metaphor, the roots of the tree represent the meta-principles, which help to resolve conflicts between legal principles. It is often the case that several legal principles apply at the same time, either in alignment or in conflict with each other. Think of controversial ipso facto clauses. Their enforcement is supported by freedom of contract and, more generally, by party autonomy. However, such enforcement could undermine effective restructuring efforts and interfere with the preservation and maximisation of estate value – another key principle at stake. How should a judge or a legislator weigh and balance these conflicting principles? This is where the meta-principles, and in particular the meta-principle of proportionality, are of use (**Chapter 5**). In this regard, it is suggested that when legal principles collide – as they frequently do – the balancing exercise should be context- and case-specific (section 5.5.).

However, this does not mean that one cannot dissect the general or typical factors that influence the proportionality analysis. In fact, these factors can be viewed as branches of the tree, linking the legal principles (trunk) and legal rules (leaves). Discovering these branches lies at the heart of this book, as it seeks to examine when group-mindful tools or solutions are justified and how insolvency law can balance conflicting legal principles in the context of intra-group financing (section 1.2.).

---

2 An enterprise group (at least an integrated one) may itself be seen as a tree, in which leaves represent separate entities and the trunk links them all together in one common business enterprise.

## 14.3 Intra-group Financing and Group Insolvency: Challenges and Solutions

### 14.3.1 Group economic and legal realities

The main challenge in dealing with insolvencies within enterprise groups is reconciling the group economic reality with the legal reality of entity separateness. While individual members of an enterprise group are recognised in law, the group itself is not treated as a distinct legal entity. Unlike certain other areas of law (e.g. competition law), where the (economic) concept of an enterprise or undertaking transcends the boundaries of a single legal entity, insolvency law traditionally operates on an entity-by-entity basis; this is referred to as the entity bias. The division of a single enterprise into separate legal entities with their own interests, governance, pools of assets and creditors, is underpinned by the doctrines of limited liability and entity shielding. The former protects shareholders from liability for debts incurred by the legal entities they establish or invest in, while the latter ensures that the shareholder's own creditors do not have direct recourse against the assets of their companies.

Without disputing the importance of limited liability – although for highly integrated groups its rationale remains questionable – we argue that entity separateness does not and should not automatically result in complete entity insulation. Hence, it should not prevent legal responses that recognise and address group dynamics without contravening the corporate form (section 2.5.). It is observed that the more significant the implication of or incursion into limited liability and asset partitioning is, the more demanding the requirements become for the application of a specific legal tool (section 3.6.). This is why, for instance, substantive consolidation, a legal tool that leads to a complete disregard of the corporate form and eliminates intercompany claims, is typically confined to rare instances involving the intermingling of assets and liabilities within a group or cases of fraud and abuse of the corporate form.

The mismatch between group commercial and legal realities is further exacerbated by the prevalence of intra-group financial arrangements. In the legal sense, these arrangements do not undermine entity separateness. Group entities retain their independent existence and interests. In practice, however, these arrangements are often driven by the interests of the group as a whole. They promote group interdependence and weaken the protection of corporate shields, which, at least in theory, should ensure the separateness of legal entities comprising the enterprise group. Undoubtedly, intercompany liability arrangements, including cross-guarantees, co-debtorship, provision of collateral, cross-entity ipso facto and cross-default clauses serve protective, risk control and risk mitigation functions (sections 6.4., 9.2.). They could also contribute to lowering the cost of debt. Nevertheless,

in a situation of financial distress, these financial arrangements might contribute to contagion across the group (domino effect), trigger holdout behaviour of some creditors, and discourage early measures to avoid insolvency (sections 6.6., 9.5.). The conflict between a single enterprise (economic form) and a single entity (legal form) becomes especially acute.

Take, for example, cross-guarantees – one of the most pervasive elements of many financial transactions. Should these guarantees be assessed in view of the group reality, or should their benefit be calculated based solely on the position of the guarantor without regard to a broader group context? This question is discussed in **Chapter 8**. The answer to this question is of great practical relevance, as it is likely to determine whether a cross-guarantee can be avoided in insolvency. We demonstrate that under UK, US and Dutch law, group considerations can in principle be taken into account by courts. Yet the application of transaction avoidance rules to transactions involving group members and the evaluation of group interest are plagued by legal uncertainty. The problem relates to the calculation of reasonably equivalent value of a guarantee and the indirect benefits for a group guarantor, co-debtor or collateral provider (section 8.3.). We support a group-mindful application of transaction avoidance rules that take into consideration group characteristics and intra-group relations and dependencies. At the same time, it should be emphasised that group interest alone, however defined, cannot justify the deprivation or sacrifice of the rights and interests of creditors of individual group companies (section 3.5.2.).

Williamson observes that "[t]ransactions that are subject to *ex post* opportunism will benefit if appropriate safeguards can be devised *ex ante*."[3] We agree. Considering the heightened risk of group opportunism, the far-reaching effects of insolvency transaction avoidance, and the inherent legal uncertainty of ex post review of transactions, it is prudent to explore alternative strategies (**Chapter 12**). These strategies include ex ante approval or a safe harbour (section 12.2.) and pre-emptive structural and contractual support arrangements, akin to those adopted in many banking groups (section 12.3.). These strategies can be relied on to promote efficient intra-group rescue financing and mitigate the problem of underinvestment, especially if such rescue financing is exempted from statutory subordination (**Chapter 7**). They furnish a degree of legal certainty within an environment characterised by legal and economic uncertainty, while shielding existing creditors against group opportunism.

3 O.E. Williamson, Opportunism and its Critics, Managerial and Decision Economics, Vol. 14, 1993, p. 105.

### 14.3.2 "Extension effect" in insolvency law

The limitations of a single-entity approach and the necessity of a group-mindful approach become even more evident when group restructuring and the preservation of group synergies (group value) are at stake. Chapters 10, 11 and 13 deal with different legal tools that aim to safeguard group value and respond to the disruptive consequences of intra-group financial arrangements. What these tools have in common is that they extend the effects of insolvency law rules and protections to third (non-debtor) parties. In other words, they give an "extension effect" to insolvency law, (i) enabling the restructuring of group liabilities in a single procedure (third-party releases), (ii) providing a temporary respite from enforcement actions and allowing for a group-oriented solution (extension of a bankruptcy stay to debtor's affiliates), and (iii) advancing restructuring and protecting going concern value of the group's business by depriving certain contract clauses of their force or otherwise addressing their disruptive effects (intercompany ipso facto and cross-default clauses). These legal tools bridge economic and legal realities, preserving the separate legal identities of group entities while averting complete insulation. Nonetheless, they inevitably raise questions about compliance with legal principles such as equal treatment of creditors, protection of legitimate expectations and party autonomy. The most acute conflict is usually between the preservation and maximisation of estate value, on the one hand, and the protection of legitimate expectations and freedom of contract, on the other hand.

When a debtor files for bankruptcy, in exchange for numerous insolvency law protections, it usually undergoes a certain level of scrutiny mandated by the insolvency process. It also incurs some reputational costs. Yet third parties benefitting from the "extension effect" (non-debtor group members) may escape this scrutiny. This is why the application of legal tools with an extension effect must be carefully balanced and guided by meta-principles. The outcomes of this balancing exercise and our specific suggestions are outlined in the concluding sections of the chapters in Part V of this book: section 10.3. (third-party releases), section 11.4. (extension of an enforcement stay to group affiliates), section 13.4. (treatment of cross-entity ipso facto and cross-default clauses). Some of these suggestions are elaborated upon below.

*Third-party releases*. **Chapter 6** describes how the "triangle of rights and liabilities": principal debtor ⇔ guarantor ⇔ creditor, complicates restructuring efforts due to: (i) the existence of a recourse or ricochet claim (e.g. indemnity, contribution) of the paying guarantor (i.e. "ricochet problem"), or (ii) the fact that the enforcement against the guarantor could lead to its collapse, potentially undermining the effectiveness of the principal debtor's restructuring (i.e. "orphan restructuring problem"). In response, group debt deleveraging and debt adjustment can be carried out via a third-party

release. It is a practical instrument that helps to resolve some complexities of group financing and synchronise legal responses with actual business and group financing models.

Third-party releases are the subject of heated debates because they affect the rights of creditors against third (non-debtor) parties and the obligations of these parties, all without opening separate proceedings against them. This is one of the reasons why countries adopt divergent approaches to third-party releases. Whereas English courts adhere to a pro-release approach and consider third-party releases a common practice in schemes of arrangement, and while in the Netherlands third-party releases are permitted in WHOA schemes, though not necessarily outside them, the position of US courts is not uniform – they either disallow third-party releases or allow them in limited circumstances (sections 10.2.2, 10.2.3, 10.2.4).

Third-party releases are a welcome addition to the restructuring toolbox. They can safeguard the continuity of a group enterprise against destabilising effects of intercompany guarantees and other forms of cross-entity liability arrangements. The simultaneous enforcement of cross-guarantees could create additional costs and result in conflicting judgments, difficulties in implementing group-wide reorganisation, and ultimately lead to the destruction of (some) enterprise value. The case of Oi Brazil perfectly illustrates this (section 1.1.3.). While acknowledging the practical utility of third-party releases, it is emphasised that they must not strip group guarantees of their protective function. Hence, we suggest the introduction of a "group best-interest-of-creditors" test, which would ensure that a guaranteed creditor is not deprived of its baseline entitlements and the benefits afforded by a valid security arrangement and its property rights (i.e. a claim against a third party). It is also stressed that the case for a third-party release is stronger if such a release is consensual, relates to the debtor's own claim, or if the non-debtor third party is entitled to file a recourse claim against the debtor in full, potentially undermining restructuring efforts (section 10.3.2.).

*Extension of enforcement stays*. A less far-reaching tool addressing the "triangle of rights and liabilities" is the extension of an enforcement stay to the debtor's affiliates (**Chapter 11**). Unlike a release, a stay does not definitively adjudicate rights. Rather, it preserves a status quo and the potential for restructuring. Generally, the availability, design and scope of a stay vary significantly between different jurisdictions, and sometimes also within the same jurisdiction depending on the applicable procedure. Among the national laws studied in this book, the automatic stay under the US Bankruptcy Code stands out as the most potent, given its extremely broad scope. Dutch law provides for a stay in bankruptcy and suspension of payments procedures but does not affect the rights of secured creditors. These "separatist" creditors can enforce their security rights as if there were no bankruptcy proceedings. UK law offers a patchwork of different rules

and procedures that might be used on a stand-alone basis or in combination with other procedures (sections 11.2.1, 11.2.2., 11.2.3.). The lingering question is whether a stay can and should be extended to non-debtor group entities, acting as guarantors, co-debtors or collateral providers.

It is argued that given the group economic reality, extending the protective shield of an enforcement stay to the debtor's affiliates may be necessary to facilitate the efficient restructuring of an enterprise group. This extension aims to preserve key group synergies, maintain the operational continuity of group companies, and strengthen the debtor's bargaining power. UK law does not seem to permit such an extension. US and Dutch law, to one extent or another, grant courts the authority to extend the stay to enjoin actions against third parties (section 11.3.). However, taking into account that a stay encroaches on creditors' enforcement rights, its extension should not be automatic. Importantly, it must not unfairly prejudice the rights of affected creditors or cause substantial detriment to them. The extension of a stay to non-debtor parties should be accompanied by adequate protections to prevent potential abuse. This may require mirroring the protections inherent in the original stay and allowing for the possibility to lift the extended stay if its continuation harms the creditor. For instance, this could occur if the value of collateral provided by the third party declines or if the third party attempts to conceal assets or engages in another opportunistic behaviour (section 11.4.2).

The case for an intra-group operation of an insolvency stay appears to be stronger when the enterprise group is integrated, and a non-debtor group company plays an integral part in the debtor's restructuring, or when the restructuring involves a third-party release. In both cases, extending the stay becomes essential for the efficiency of the reorganisation. But even in cases involving asset sales, the extension of a stay might be conducive to value maximisation insofar as it preserves the group's asset pool, which is worth more than the assets of individual group companies sold separately, on an entity-by-entity basis. An illustrative case is the bankruptcy of Nortel Networks (section 1.1.2.), where the aggregate sale of assets belonging to different group companies helped to secure the highest purchase price.

*Limitations on intercompany ipso facto and cross-default clauses*. **Chapter 9** introduces ipso facto and cross default clauses, while **Chapter 13** focuses on their operation within the group insolvency context. Ipso facto clauses are contractual provisions that entitle the creditor to terminate, amend or accelerate the contract if certain conditions are met, including the debtor filing for bankruptcy or encountering financial distress. Cross-default clauses, on the other hand, establish that a default on one non-insolvency-related obligation (such as failure to fulfil payment obligations) triggers a default on another obligation. Both types of clauses are prevalent in financial contracts, including bond and loan documentation, as well as repurchase

and securities lending transactions. They often connect or implicate several companies within the same enterprise group, thereby increasing the correlation between separate entities and further eroding entity separateness. Particularly in times of financial distress, this correlation and interdependence can quickly escalate into a group-wide contagion.

The desire to promote restructuring and protect the going concern value of the debtor's business has prompted many countries, including the UK, the USA and the Netherlands, to interfere with parties' freedom of contract. Freedom of contract is in retreat, even in jurisdictions traditionally seen as strongholds of freedom of contract, such as the UK. This manifests in various limitations imposed on ipso facto and cross-default clauses (sections 9.3. and 9.4.). The question is whether and how these limitations apply, or should apply, to intercompany ipso facto and cross-default clauses. That is, when is it justifiable to extend insolvency law protections against certain contractual terms in a group context?

It is argued that a group-level extension of insolvency law safeguards may be warranted when the enterprise group is highly integrated, leading to a correlation between the fates and financial positions of group entities. This was, for instance, the case of the Lehman Brothers group (section 1.1.1.), in whose bankruptcy the US court granted an extension effect to the ipso facto prohibition (section 13.2.3.). Conversely, extending an ipso facto ban may be less proportionate if a group is decentralised and the insolvency risks of its entities are not correlated. To ensure a proportionate response, we suggest that the unenforceability of cross-entity ipso facto clauses is reserved for specific situations or contracts, such as those containing cross-default clauses (section 13.4.2.).

As for cross-default clauses, we make several observations. First, unlike ipso facto clauses, cross-default clauses are generally perceived to be less objectionable and thus warrant legal protection. Second, for the sake of promoting efficient restructuring and value preservation, it is asserted that a restructuring plan (e.g. a reorganisation plan under Chapter 11 or a WHOA plan) should be able to neutralise a debtor's default triggered by a default of another group entity. Third, should the law require the curing all defaults for the assumption or de-acceleration of a contract, as is typically the case under the US Bankruptcy Code, it is sensible to apply such a requirement only to substantially related or economically interdependent contracts (section 13.4.3.). This suggestion aims to strike a balance between the creditor's legitimate interests and reliance on a contract term, and the debtor's interest in pursuing effective value-preserving reorganisation.

## 14.4 Key Observations: Guiding Factors

### 14.4.1 In search for guiding factors

In her insightful book, Pistor describes how modern enterprises, such as Lehman Brothers, have turned the "legal partitioning of assets with the help of corporate law into an art form".[4] The division of a firm, representing a single interconnected economic ecosystem, into dozens, if not hundreds, of legal shells is a modern corporate reality. Be that as it may, insolvencies of giants like Lehman Brothers, Nortel Networks, Oi Brazil, and more recently of LATAM Airlines, Hertz and FTX, attest to the fact that group companies not only live together but also die (or recover) together. They show that many subsidiaries can hardly survive or raise funds without support from other group members. This support translates, inter alia, into various intra-group liability arrangements, such as intra-group guarantees and co-debtorships, which weaken or take away what is praised as the greatest privilege that shareholders enjoy – limited liability. While not all intra-group financing has a similar effect of perforating the corporate veil, they all tend to increase group interdependence and thereby diminish the persuasiveness of the entity separateness narrative.

This book explores how insolvency law can better respond to the economic realities of corporate groups and their financial arrangements. Based on this exploration, we sought to dissect a number of general considerations or factors that play a role in deciding whether a group-mindful approach should be adopted. Reprising the tree metaphor, these factors are branches hidden underneath the leaves. Without pretending to have discovered all the relevant factors, we highlight those that transpire throughout the entire book. They do not pre-determine any concrete result and should not be seen as rigid instructions. However, they could serve as key indicators, pointing in a certain direction or suggesting a decision, while leaving sufficient room for flexibility and case-specific considerations.

### 14.4.2 Group integration and interdependence

The first factor or theme that can guide the application of various legal tools, tackling intra-group financing, is group integration and interdependence. Such integration can be backed by a wide range of operational and financial elements. Among them are reliance on the group for business commitments (supply of essential materials, provision of licenses and know-how, leasing of premises, etc.), access to funds (e.g. intra-group loans, cross-guarantees, cash pooling), services (e.g. data management, IT, marketing), and other

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

forms of collaboration (information sharing, development & implementation of a business plan or strategy). Examples of highly integrated groups include Lehman Brothers, Nortel Networks, and Oi Brazil.

For fully integrated business, where group entities essentially engage in a common business and depend on each other, and where the collapse of one company is likely to lead to the failure of other group companies or of the entire group, context-specific tools and solutions tailored to the group's circumstances are justified. The factor of group integration appears in most chapters of this book, whether we are discussing transaction avoidance and the recognition of indirect benefits in intra-group financing (Chapters 8, 12), group debt deleveraging and adjustment via third-party releases addressing ricochet and orphan restructuring problems (Chapters 6, 10), the preservation of group synergies and group value through the extension of an insolvency stay to debtor's group affiliates (Chapter 11), or limitations of contract clauses, such as intercompany ipso facto and cross-default clauses (Chapters 9, 13).

The Guide to MLEGI recognises that a widely-based, possibly group-wide insolvency solution "may be of particular importance where the business of the enterprise group is conducted in a closely integrated manner."[5] The relevance of group integration should come as no surprise, as the discussed tools or solutions aim to leverage synergies across the group and connect the group (economic) reality with the legal reality of entity separateness. By contrast, what is justified and proportionate for integrated and interconnected enterprise groups may be less feasible or even disproportionate for groups of companies with a significant degree of decentralisation and independence. For these groups, where individual group companies are not dependent on each other and, as a result, the failure of one of them is unlikely to spill over to other parts of the group – in other words, where entity separateness is strong – the use of group-sensitive insolvency law tools is less necessary from the proportionality analysis (section 5.4.3.).

### 14.4.3 Financial situation of non-debtor group entities

The second factor relates to the financial situation of a group company seeking the benefits of extended insolvency law safeguards. If such a company is solvent and does not face cash flow or balance sheet insolvency due to a creditor action, the argument for using insolvency law "superpowers" and extending insolvency law protections, such as debt discharge and adjustment, enforcement stay, and suspension or unenforceability of ipso-facto and cross-default clauses, becomes weak.

5 Guide to MLEGI, para. 69.

After all, it is insolvency law and its principles, such as equal treatment of creditors, but most importantly, value preservation and maximisation, that serve to justify encroachment on creditors' property and contractual rights. Without insolvency risk, sustaining this justification becomes difficult, and freedom of contract, in its broadest sense, should prevail. Alongside matters of value preservation and maximisation, an insolvency process seeks to guarantee procedural and substantive fairness, underpinned by transparency, participation rights and equitable distribution of value. This is why the justification for a third-party release might be called into question when the third party benefiting from insolvency law tools does not subject itself to the requirements of an insolvency process and is not financially distressed, either before or as a result of the enforcement of a creditor's claim under a guarantee, co-debtorship, or collateral arrangement (see section 10.3.2.). Similar observations were made regarding the extension of an enforcement stay to non-debtor group entities (section 11.4.2.) and limitations on cross-entity ipso facto clauses (section 13.4.2.).

There may be cases where the enforcement of a creditor's right against a solvent group entity, acting as a group guarantor, co-obligor or collateral provider, damages or even dismantles group synergies and value, without serving a legitimate objective or the creditor's interests. In situations like this, a certain degree of flexibility could be considered. Among the jurisdictions examined in this book, the USA has the most flexible bankruptcy law. This is evidenced in the absence of any mandatory threshold of material insolvency or financial distress for accessing Chapter 11 – the principal restructuring framework. This enables the participation of different group entities, whether solvent or insolvent, in a reorganisation. The absence of an insolvency requirement, together with the affiliate-filing rule, flexible jurisdictional standards, and other important benefits offered by the US Bankruptcy Code (e.g. DIP financing regime, powerful automatic stay) have made the USA a favoured destination for restructurings of enterprise groups, including foreign ones. However, it is important to note that when group companies, whether insolvent or solvent, file for bankruptcy in US courts, they subject themselves to the obligations and requirements of the bankruptcy process, including transparency. The flexibility and lack of an insolvency threshold have also contributed to the attractiveness of English schemes of arrangement. Despite the limited toolbox of schemes compared to US Chapter 11 (e.g. no automatic stay, no cross-class cram down), they have become a popular instrument for group (financial) restructuring.

### 14.4.4 Purpose and nature of the procedure

The third factor refers to the purpose and nature of the procedure. Two different scenarios should be distinguished concerning the purpose. The first scenario involves (i) financial and/or operational restructurings, where

the business remains with the debtor company or a group of companies, or (ii) a going concern sale of the business to outside investors. Hence, the first scenario encompasses both "restructuring" per se, which removes debt from the business, and "asset-deal restructuring", which removes the business from its debt. The second scenario entails a piecemeal liquidation and closing down of the business. It does not matter whether such liquidation is accomplished through a Chapter 11 plan, a WHOA scheme, or any other procedure.

Third-party releases, extended enforcement stays, and restrictions on certain contract terms aim to preserve the going concern value of the debtor and of its enterprise group – value that would otherwise be lost if creditors were allowed to enforce their rights against members of the enterprise group. That being said, in the context of a piecemeal liquidation, the rationale for preserving the debtor's or the group's going concern value is less compelling. Therefore, the discussed tools become less feasible or indeed unnecessary, as they would not achieve the goals for which they were invented. However, there may be some exceptions. For example, the extension of a stay to non-debtor group companies is warranted even in a liquidation and asset sale scenario, provided that it facilitates an orderly liquidation of an enterprise group and the coordinated sale of its assets. Assets of separate group entities may be worth more if sold together. The case in point is the bankruptcy of Nortel Networks. This case demonstrates that the preservation of assets spread across different group companies, and their coordinated, global sale could secure the highest purchase price, being in full compliance with the principle of value maximisation.

When it comes to the nature of the procedure, a distinction should also be made between, on the one hand, a "light touch" or "skinny" financial restructuring,[6] which primarily targets the company's debts (rather than assets) and involves well-informed, sophisticated and strongly adjusting creditors, such as bondholders and bank lenders and, on the other hand, a full-fledged financial and operational restructuring that has an impact on the debtor's assets and affects the rights of less sophisticated parties, including employees, trade partners and tort victims. Schemes and scheme-like procedures are increasingly being employed to deleverage complex financial capital structures.[7] These procedures are correlated with additional flexibility, embraced to accommodate the realities of group financing,

6 I. Mevorach, A. Walters, The Characterization of Pre-insolvency Proceedings in Private International Law, EBOR, Vol. 21, 2020, pp. 855-894.

7 S. Paterson, Corporate Reorganization Law and Forces of Change, OUP, 2020, exploring the proliferation of a new type of corporate restructuring, one that only implicates financial liability and certain participants. This form of financial restructuring ensures the preservation of the group's cash flow, as the activities of operating companies and claims of trade creditors and employees remain unaffected by the restructuring process.

and supply legal tools to achieve group-mindful solutions. In the UK, for instance, schemes and third-party releases contained therein are often utilised to restructure group financial obligations under cross-guarantees and co-debtorship arrangements.[8] In the Netherlands, third-party releases and extended stays or cooling-off periods within WHOA schemes are directed at group financial arrangements, which frequently involve creditors who are professional financiers. Importantly, intra-group financing and the corresponding insolvency law tools rarely encroach upon the rights of vulnerable constituencies. In our view, this could justify some flexibility in the application of legal tools to implement financial restructuring and address complex financial arrangements.

Parties involved in intra-group financing tend to be better risk bearers, as they can negotiate a legal arrangement aligned with the assumed levels of risk and expected return. These parties are the ones who commonly benefit from intra-group liability arrangements, like intra-group guarantees, and have a good understanding that they are effectively transacting with the entire group. This perception is reinforced by the existence of cross-entity liability arrangements, as pointed out by US courts in the Oi Brazil case. Why is this important? When a sophisticated party engages with a group enterprise, it should be able to foresee that if the group requires deleveraging or is on the brink of failure, group-specific legal tools like third-party releases might be invoked. This has to do with the protection of legitimate expectations (section 4.4.2.). Guided by the meta-principles of fairness and proportionality, we argue that group-mindful legal tools are more defensible and justifiable in cases of financial restructuring involving group entities and sophisticated financial creditors, as opposed to non-adjusting or poorly-adjusting creditors. Perhaps this is the reason why third-party releases have recently come under fire in cases involving mass torts (e.g. Purdue Pharma) but have encountered less criticism in cases concerning the restructuring of intra-group financial obligations.

### 14.4.5 Prevalence of public interest

Traditionally, insolvency law has been seen as an instrument to resolve conflicts arising within a single entity, conflicts between the company and its investors – shareholders and creditors.[9] Insolvency law therefore is, for the most part: (i) microprudential: single entity-focused and designed to protect

8 The restructurings of the Dutch retailer HEMA, Switzerland-headquartered aviation services company Swissport, vending machine operator Selecta, and Spain's multinational group devoted to entertainment and leisure Codere, to name a few, have been carried out with the involvement of financial restructuring in the UK.

9 S.L. Schwarcz, Beyond Bankruptcy: Resolution as a Macroprudential Regulatory Tool, Notre Dame Law Review, Vol. 92, 2018, p. 729.

the interests of individual debtors and their creditors; (ii) contractarian: implementing the idea of the creditor's bargain and solving the coordination problem between creditors of a single entity; and (iii) reactive: centred around post-crisis asset realisation and the allocation of proceeds among creditors. The case is different for the resolution of financial institutions – a difference that became apparent in the aftermath of the Global Financial Crisis. This is when policymakers realised that a new approach is needed to prevent bank bailouts, preserve financial stability, and prevent social harm and public unrest. In this respect, Lubben contends that the primary aim of bank resolution is not adjudicatory (i.e. collective handling of claims and their enforcement), but rather regulatory.[10]

It is observed that the more prominent the role of the public interest, the greater the likelihood that law will acknowledge and give effect to a group's reality in one way or another. In economic terms, the issue at stake is the (degree of) negative externalities created by a certain behaviour. The larger these externalities, the higher the public interest concerns are, and the more likely the "groupness" is to be recognised and acted upon. This is why areas of law that tackle negative externalities and serve public interest (e.g. tax, competition and anticorruption law) tend to look beyond the fiction of entity shells.[11] Said otherwise**,** group-mindful solutions are powered by public interest.

The considerations of public interest underpin many post-GFC reforms in the field of bank resolution, promoting the emergence of legal tools and mechanisms at a group rather than at an individual entity level. These tools include, inter alia, group recovery and resolution plans, group financial support agreements under the BRRD, a legal regime that explicitly recognises group interest within certain boundaries (section 12.3.2.), special rules making intercompany ipso facto clauses unenforceable (section 13.2.4.), models of bank resolution, and the related requirements for pre-positioning of resources within banking groups (section 12.3.3.).

---

10 S.J. Lubben, A Functional Analysis of SIFI Insolvency, Texas Law Review, Vol. 96, 2018, p. 1396.

11 For example, EU competition law relies on the notion of an "undertaking" that covers "any entity engaged in an economic activity, irrespective of the legal status of that entity and the way in which it is financed, and thus defines an economic unit even if in law that economic unit consists of several persons, natural or legal." C-516/15, *Akzo Nobel and Others v. Commission*, 27 April 2017, para. 48. As a result, formal boundaries between the legal entities within a single economic unit and their separate legal personalities – separate in a sense of being insulated – lose their salience when dealing with conduct that constitutes an infringement of competition law. Case C-882/19, *Sumal SL v. Mercedes Benz Trucks España SL*, 6 October 2021, extending liability from a parent company to a subsidiary within the same "economic unit".

Coordinated resolution of financial distress in banking groups and financial conglomerates is logical because resolving a single company without considering its interconnectedness with other group entities and its integration in the financial system can be short-sighted and create systemic risk. Some pre-emptive strategies, including the preparation of group recovery plans, entering into group support agreements to ensure financing of key group companies in a stress situation, and their insolvency insulation through prepositioning of resources, should also be considered for non-financial enterprises (section 12.4.2.). These strategies are particularly relevant and proportionate for those among them whose insolvency poses difficult questions related to the provision of vital public services and raises employment, environmental, health and safety concerns. For such significant non-financial enterprises, there may be a role for public interest as part of the balancing between conflicting legal principles.

The enterprise group is one of the primary forms of organising economic activity. In fact, virtually every major firm is organised as a group. From early precursors of business groups, such as the Medici system of partnerships of the 15th-16th centuries and the European colonial trading empires of the 17th centuries (i.e. the Dutch and English East India Companies), to the emergence at the end of the 19th century of the first modern groups of companies characterised by multi-layered and hierarchical structures of ownership and control, groups have occupied an important place in societies' economic and political life. Yet the enterprise group is a curious case. It combines separate entities and (often) an integrated business enterprise, sometimes pierced or perforated by an elaborate network of intra-group financial arrangements and dependencies. The study of corporate groups is complicated by the diversity of their types and features, and the multiple levels of regulation (international, regional and national) that reflect the international character of most groups. It is hoped that this book will contribute to a better understanding of enterprise groups, intra-group financing, and their intersection with insolvency law.