European Business Organization Law Review 8: 179-194

DOI10.1017/S1566752907001796

Appropriate Treatment of Corporate Groups in Insolvency: A Universal View

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Abstract

This paper proposes a conceptual framework according to which a suitable approach for treating corporate groups in insolvency, under domestic law, can be devised. Currently, the event of insolvency within a corporate group is often poorly dealt with under both domestic and international regimes. However, the matter demands special consideration, especially as 'linking' between affiliated group companies in their separate insolvencies may be necessary. This paper examines how 'linking' tools might be incorporated into domestic laws and ultimately harmonised, so that a level playing field for insolvencies within corporate groups (wherever they may take place) is established. It suggests three main features which are required for any workable solution. First, the system should be prudent and recommend linking tools only when these are needed. Second, clear and objective tests should be used to decide on any proposed mechanism, promoting certainty and clarity in judicial outcomes. Finally, the international scenario should be taken into account as well, in order to prevent possible manipulation by the debtors and use the benefits of treating the corporate group globally. Using these three concepts, the paper examines the various linking tools available, from procedural

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consolidation to contribution orders. It concludes by asserting that using the proposed concepts to construct the required linking mechanisms will help to achieve effective tools that are broadly accepted and provide an appropriate platform for dealing with corporate groups in their insolvencies.

Keywords: groups of companies, multinational corporate groups, corporate insolvency, consolidation, contribution order, subordination, harmonisation of laws.

1. INTRODUCTION[1]

The 'corporate group' is the most typical structure of modern enterprises,[2] exploiting the idea of a company's distinct personality, which is detached from the identity of its shareholding members, and the benefit of limiting the holding company's liability for the subsidiaries' debts.[3] Therefore, it is of great practical importance to consider the legal consequences of the operation of corporate groups (domestic and multinational), including the event of their collapse. Nonetheless, it has been observed that a rather chaotic platform supports the operation of corporate groups (domestic and multinational).[4] At present, most domestic and international legal regimes do not provide a fully developed law specifically tailored to corporate groups, as distinct from single companies.[5] With

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[1] Paper based on a presentation given by the author at the UNCITRAL/INSOL International Insolvency Colloquium, 14-16 November 2005, Vienna International Centre, Vienna, Austria.

[2] As noted in P.L. Davies, *Gower and Davies' Principles of Modern Company Law*, 7th edn. (2003) pp. 178, 202, even relatively modest businesses often operate through groups of companies and large businesses invariably do so. The impact of the corporate group in world business is even greater considering operations by linked entities using various legal forms (such as joint ventures and licence agreements), other than the conventional hierarchical structures and the full ownerships of affiliates. See V. Bornschier and H. Stamm, 'Transnational Corporations', in S. Wheeler, ed., *The Law of the Business Enterprise* (1994) p. 334.

[3] See, for instance, D. Milman, 'Groups of Companies: The Path towards Discrete Regulation', in D. Milman, ed., *Regulating Enterprise* (Oxford, Hart 1999) p. 218 at p. 220; Davies, op. cit. n. 2, at p. 202; P.I. Blumberg, *The Multinational Challenge to Corporation Law: The Search for a New Corporate Personality* (New York, Oxford University Press 1993) pp. 58-60.

[4] See C.M. Schmitthoff, 'Introduction', in C.M. Schmitthoff and F. Wooldridge, eds., *Groups of Companies* (London, Sweet & Maxwell 1991) pp. xiv-xv.

[5] Certain legal regimes have adopted a statutory solution and developed 'a law of corporate groups', most notably the German Stock Corporation Act 1965 (*Aktiengesetz*), reproduced in English in K.J. Hopt, ed., *Groups of Companies in European Laws, Legal and Economic Analyses on Multinational Enterprises*, Vol. II (Berlin/New York, De Gruyter 1982) pp. 265-295, although it has been criticised as capable of improvement. See K.J. Hopt, 'Legal Elements and Policy Decisions in Regulating Groups of Companies', in Schmitthoff and Wooldridge, op. cit. n. 4, at p. 81. See also H. Weidemann, 'The German Experience with the Law of Affiliated Enterprise', in Hopt, op. cit. n. 5, at p. 21.

respect to the insolvency of corporate groups, in particular, national and international insolvency regimes usually lack sufficient solutions.[6] This 'absence' was much emphasised and received considerable attention during the past decade as a result of the collapse of several large corporate groups that operated worldwide.[7]

This paper is built upon the basic premise that, in order to accommodate the particular case of corporate groups in insolvency, we need to have some sort of mechanism that will enable us to impose a link between affiliated companies in their insolvency proceedings.[8] Indeed, linking is essential in order to meet the challenges presented by insolvencies within corporate groups, especially in those situations where the components of the group were highly interdependent or even where the group maintained the separate entities lawfully but they all formed a coherent business. Thus, treating the entities separately in the course of insolvency may impede the planning and implementation of a package sale or a restructuring plan. It also refers to the need to meet legitimate expectations of a variety of different groups of creditors of separate entities and provide equitable treatment and appropriate remedies to all those involved with the group.

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[6] Basically, this is because *prima facie* there is no 'corporate group' entity. Although there are national regimes that are less strict in their adherence to the entity doctrine in the context of corporate group insolvency (see, for instance, the reforms in this respect in the New Zealand law and the mechanisms for treating corporate groups in their insolvency available under the US bankruptcy regime, *infra* nn. 25, 35, 44, 45 and 50), the doctrine is still strongly grounded in economically advanced countries. See P.T. Muchlinski, *Multinational Enterprises and the Law* (1999) p. 328. Similarly, cross-border insolvency models lack sufficient reference to this matter. Thus, the express scope of the UNCITRAL Model Law encompasses a 'single debtor' situation (see, e.g., Article 1(c) of UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment; hereinafter, UNCITRAL Model Law). However, the topic of corporate groups in insolvency is currently under consideration by UNCITRAL Working Group V (insolvency law). See United Nations, 'Insolvency law: Possible Future Work', Note by the Secretariat, UN Doc. A/CN.9/596 (2006), available at: <http://daccessdds.un.org/doc/UNDOC/GEN/V06/517/90/PDF/V0651790.pdf?OpenElement>. Council Regulation (EC) No. 1346/2000 on Insolvency Proceedings (hereinafter, European Insolvency Regulation) does not include any specific provisions for dealing with such cases. See also I.F. Fletcher, *Insolvency in Private International Law* (Oxford, Oxford University Press 2005) p. 387.

[7] See, for instance, the collapse of the Maxwell group (Re *Maxwell Communications Corp*. [1993] 1 W.L.R. 1402 (Ch. 1993); 170 B.R. 800 (Bankr. S.D.N.Y. 1994)), Polly Peck (Re *A Company No. 009296 of 1990*, 1992 B.C.C. 510 (Ch. 1992)) and, more recently, Enron (Re *Enron*, Chapter 11 No. 01-16034 (AJG) (Bankr. S.D.N.Y.)), Worldcom (Re *Worldcom*, Chapter 11 No. 02-13533 (AJG) (Bankr. S.D.N.Y.)) and Parmalat. The latter yielded a large number of proceedings. See, for instance, the litigation in the *Eurofood* case (*Eurofood IFSC Ltd* (Trib (I)) [2004] I.L.Pr.14; *Eurofood IFSC Ltd (No.1)* (HC (Irl)) [2004] B.C.C. 383; *Eurofood IFSC Ltd (No.1)* (Sup Ct (Irl)) [2005] B.C.C. 999; *Eurofood IFSC Ltd (No. 2)* (Sup Ct (Irl)) [2005] I.L.Pr.3; *Eurofood IFSC Ltd* (AGO) [2005] B.C.C. 1021; *Eurofood IFSC Ltd* (ECJ) [2006] B.C.C. 397).

[8] For an analysis of the advantages of unifying the insolvencies of related companies, particularly multinational corporate groups, see I. Mevorach, 'The road to a suitable and comprehensive global approach to insolvencies within multinational corporate groups' 15(5) *JBLP* (2006).

In this paper, I focus on the options for providing such appropriate mechanisms within domestic laws. As noted above, at the international level, the issue of multinational corporate groups has not been dealt with sufficiently so far,[9] although it is even more crucial to deal with such insolvencies.[10] No doubt, an international model that will address this scenario is of great importance.[11] However, one of the main causes for this 'neglect' is the fact that it is an area where national legal regimes differ widely, making it extremely difficult to devise an international model that will be acceptable to a wide range of countries.[12] It seems, therefore, that complementary to any international attempt to deal with the matter of multinational groups, or even as a basic platform for a global model, we need to promote sufficient tools within domestic laws. However, this in itself can be achieved most effectively via international bodies providing guidelines or recommendations in this area of law for implementation within national laws.[13] As a consequence, uncoordinated unilateral state policies will be reduced. The idea is to improve harmonisation of the rules pertaining to corporate groups by proposing suitable policies and workable solutions. The question here is how one can construct an appropriate approach to the matter which could be recommended universally.

As a starting point for our discussion, I will suggest three concepts which I believe to be instrumental for the formulation of a workable solution to corporate groups in insolvency within national regimes. These concepts reflect the common ground upon which a suitable policy that can promote an efficient and fair result for such scenarios, wherever they may take place, could be set up. Subsequently, I will consider some initial potential linking tools (which are already available under certain legal regimes) in light of these three concepts, in order to determine whether there is a need for some refinements or additional features to those mechanisms.[14]

2. THE BASIC FEATURES OF A SUCCESSFUL ATTEMPT TO CONSTRUCT A WORKABLE SOLUTION

2.1 **'Proceed with caution'**

Most importantly, when considering a proper approach to corporate groups in insolvency, one that can 'live in peace' with other basic features of domestic laws, it

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[9] See *supra* n. 6.

[10] See *infra* s. 2.3.

[11] See *supra* n. 8.

[12] There are additional complexities such as the ability to determine which jurisdiction will be the appropriate one to handle a multinational corporate group insolvency process.

[13] For instance, as part of the UNCITRAL Legislative Guide on Insolvency Law (2004), available at: <http://www.uncitral.org/en-index.htm> (hereinafter, UNCITRAL Legislative Guide).

[14] See *infra* ss. 4 and 5.

is eminently clear that it should avoid embracing means which can be regarded (at least in some views) as too 'extreme'. Our main concern is that linking between separate companies (in their insolvencies) may interfere with the 'twin' notions normally attached to corporations: separate legal personality and limited liability.[15] There is thus a sort of 'battle' between the desire to find ways of connecting between the components of a corporate group and in certain cases even dismantling the walls or 'piercing the veil' (all for the purpose of benefiting the insolvency process and promoting the reliability of the insolvency system), on the one hand, and the obvious demands on behalf of traditional corporate theory that the integrity and distinctiveness of the corporate form will be respected, on the other. Hence we are required to 'square the circle' and strike a balance between the need for a compatible approach and the promotion of commercial enterprise, taking into account the specific characteristics of corporate groups, the different policies regarding this issue and the various possible circumstances and scenarios that may exist in any given case. Essentially, then, the idea is to 'proceed with caution' and ascertain when linking mechanisms need to be applied, while at the same time limiting their capacity and scope. One way of achieving this is by using flexible tools that can accommodate the needs of the particular case. These mechanisms should build upon functional factors related to the implementation of insolvency laws, while seeking the least harmful and threatening (to corporate personality and limited liability) solution. Interventionist mechanisms (that involve piercing the veil) should demand close inspection of the circumstances and will be applied in exceptional and well-defined cases. These will then facilitate corporate groups' insolvency proceedings and provide appropriate remedies within the insolvency regime, while leaving open the legitimate use of the corporate form for its appropriate purposes. One derivative of this notion is that the boundaries and the consequences of the use of corporate form in the context of corporate group insolvency will be better formulated. Only then can the circle be squared and a proper balance struck between insolvency goals and traditional corporate theory.

2.2 Using clear and objective tests

Another key factor in attempting to construct an appropriate solution to our problem is to aim for a standardised set of rules, the function of which is to enable equivalent protections and facilities across countries that are clear enough to be used in a consistent and predictable manner. As suggested at the beginning of this paper, applying rules universally can be done by proposing mechanisms in the form of a series of guidelines or recommendations provided in a 'top-down' manner, namely via an international mechanism, to be adopted by national regimes,[16] thus reducing diversity in national regulation.

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[15] See *supra* n. 3.
[16] See *supra* n. 13.

Essentially, in order to improve the harmonisation of legal rules and their implementation, we need to design tests that will guide the insolvency courts when they need to decide on using any linking mechanisms. General provisions that give very wide discretion to courts with no accompanying guidance will be prone to differences in interpretation. This is especially problematic with respect to the more 'interventionist' tools that involve a complete unification of the affiliates (taking into account the first concept mentioned above). Thus, any proposed linking mechanism should be accompanied by clear and well-specified tests to assess its appropriateness, using typical examples, in order to promote certainty and clarity in judicial outcomes.

In addition, in our attempt to match the solutions to the demands of the case, as suggested with respect to the first concept mentioned above, we should be cautious not to end up with too many options, which will defeat certainty and predictability. Thus, trying to accommodate every slightly different scenario will be fruitless. 'Over-flexibility' should be avoided, and some measure of generalisation across cases and scenarios should be promoted to reduce vagueness.

Most importantly, the more the tests for determining the specific tool that should be applied are objective and based on economic realities, the more the conclusion of the case will produce similar and consistent results (even when we look at different national laws). Ultimately, creditors will be able to assess what means could be applied in the case of a particular corporate group failure, regardless of the location in which the proceedings will actually take place. In addition, it would not be reckless to predict that any proposed mechanism will probably be accepted more willingly by domestic regimes if it aims to reflect the economic truth of the group in question.

2.3 Planning ahead for the international scenario

Finally, when considering policy options for domestic approaches, both national and multinational groups should be considered. It is important to ensure that groups cannot evade legal consequences (in the context of insolvency) or be deprived of the benefits that the approach may propose if certain parts of the group are located abroad. This is especially relevant due to the lack of a comprehensive international model for this issue[17] and the increasing number of multinational corporate groups due to globalisation.[18] The need for rules that enable linking between affiliates in appropriate circumstances is even more

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[17] See *supra* n. 6.

[18] Enterprises may expand beyond their national seat for various different reasons. They may aim to achieve market power or invest in foreign subsidiaries merely for the purpose of diversifying investment. See G. Kopits, 'Multinational conglomerate diversification', 32 *Econ. Int*. (1979) p. 99.

pronounced in the case of multinational groups.[19] For instance, in an intertwined group scenario,[20] the efforts that will be involved trying to disentangle assets and debts, litigate, obtain the information and so forth – all in an international arena – will be over and above what we can expect at the national level and will place an extensive burden on the insolvent estate. However, there are additional jurisdictional complexities. We need tools to link between foreign proceedings and ensure the protection of foreign creditors. We also need to prevent forum shopping. A domestic approach should take these needs into account in devising its rules, in order to 'help' promote a level playing field for insolvencies wherever they occur.

A 'universalist' approach to corporate groups can promote these needs, as it essentially adopts a global perspective towards international insolvencies. In its pure form, and with regard to single entities, this approach aims for the administration of multinational insolvencies by a single court applying a single insolvency law. In the scenario of a multi-forum, multi-law world, however, the idea is that courts will apply a 'modified universalist' approach, seeking a solution as close as possible to this ideal.[21] Thus, handling the insolvency proceedings could take a worldwide approach which will also maximise cooperation among courts.

Universalistic concepts and tools should hence be promoted within national regimes with regard to corporate groups, in order to overcome the jurisdictional complexities involved in international insolvencies in a way that facilitates the needed linkage between foreign proceedings.

3. CATEGORIES OF LINKING MECHANISMS

Insolvency scenarios within corporate groups are diversified. Accordingly, any linking mechanism will serve different purposes and will need to be implemented with some flexibility matched to the particular scenario. What we are looking for, therefore, are various forms of flexible means to link what is allegedly (or legally) disjointed.

For our purposes, the insolvency event can range from a total collapse of the entire group to the insolvency of an individual subsidiary. In addition, the legal structure of the firm may take various forms, based on equity linkages as well as contractual ones.[22] In any of these cases, the interrelations among the entities may

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[19] See *supra* n. 8 and accompanying text.

[20] Where the business of the group has been conducted (carelessly or as a strategy) as if it was a single entity, commingling the assets and debts of the various group members.

[21] See J.L. Westbrook, 'A Global Solution to Multinational Default', 98 *Mich. L. Rev.* (2000) p. 2276.

[22] See *supra* n. 2.

create an integrated group.[23] Yet, the degree of integration may differ between enterprises with different levels of autonomy enjoyed by affiliates. Furthermore, the group may be centrally controlled or decentralised in its organisational structure. In certain circumstances, the group may be strategically and artificially fragmented into separate entities or misrepresented as a single entity. Alternatively, a parent corporation may dominate a subsidiary, ensuring that the affairs of the latter are conducted by and in the interests of the parent or of the group as a whole. A member of a group may be deeply involved in the affairs of another member, while in other scenarios the group's constituents may have operated autonomously as independent profit centres. All of these are relevant circumstantial factors in devising appropriate linking mechanisms.

Taking into account the above-mentioned set of factors, we can broadly identify two categories of situations that may require linking mechanisms. The first concerns a number of affiliates under insolvency (either as a result of the collapse of the entire group or one of its divisions) and aims to efficiently handle the entire process with a fair distribution of proceeds. It relates to integrated groups in two broad classes: integrated and strongly integrated (either centralised or decentralised).[24]

The second category typically concerns the insolvency of a subsidiary company belonging to a group and the responsibility of other members for its financial state. This also encompasses the need to recapture assets or avoid prejudicial transactions. It aims to make it possible to hold a group member liable for the debts of the insolvent company in the appropriate circumstances, depending on the company's behaviour and the manner in which it exerted control over the insolvent subsidiary. This may result in responsibility for all or part of the subsidiary's debts. It also deals with the status of the controlling entity as a creditor (in the case of intra-group debts) and intra-group transactions prior to the insolvency.

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[23] Integrated groups can be defined as those enterprises that were managed as a group, jointly operating a single business that was centrally coordinated or controlled, or whose constituent companies were inter-linked resulting in financial and administrative interdependence. See various factors suggested for analysing the legal structure of corporate groups in, e.g., P.I. Blumberg, *The Law of Corporate Groups: Problems in the Bankruptcy or Reorganization of Parent and Subsidiary Corporations, Including the Law of Corporate Guarantees* (Boston, Little, Brown 1985, Supp. 1992) pp. 696-699; J.H. Dunning, *Multinational Enterprises and the Global Economy* (Wokingham, Addison Wesley 1993) pp. 222-232; J.I. Martinez and J.C. Jarillo 'The Evolution of Research on Co-ordination Mechanisms in Multinational Corporations', 20 *Journal of International Business Studies* (1989) p. 489; and P.T. Muchlinski, 'Corporations in International Litigation: Problems of Jurisdiction and the United Kingdom Asbestos Cases', 50 *ICLQ* (2001) p. 1 at pp. 9-10.

[24] Ibid.

4. SUBSTANTIVE AND PROCEDURAL CONSOLIDATION

Beginning with the first category, a 'pooling' mechanism (or substantive consolidation) is a tool that is available in certain legal regimes,[25] and may be very useful in tackling certain types of insolvency processes within corporate groups. The basic idea is to achieve just and equitable results as well as dealing with the inefficiency of handling separate proceedings in cases of strongly integrated corporate groups,[26] by addressing the companies as a single unit in the course of their insolvencies. In certain jurisdictions, this includes the disregard of intra-group claims.[27] However, before we suggest it as a universal tool that should be applied at the domestic level, some refinements of its potential use ought to be considered. Essentially, what is suggested here is to implement the three concepts described above – 'proceed with caution', 'using clear and objective tests' and 'planning ahead for the international scenario' – while acknowledging the fact that 'pooling' involves a sort of lifting of the corporate veil.[28] In other words, the critical questions here are when exactly to apply such a mechanism (or when it is truly needed), what the suitable tests for its implementation should be and how it could be made available in multinational cases.

One way of enabling a more strict application of this tool is to provide several levels of 'pooling' to accommodate the particular demands of any situation. It will not be always necessary to pool both assets and debts (and eliminate intra-group debts). For instance, if it is possible to determine which creditors dealt with which company, but the actual ownership of assets of each constituent is unresolved,

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[25] American bankruptcy courts have been using their general 'equity powers' provided in s. 105 of the Bankruptcy Code to order 'substantive consolidation' (11 U.S.C.A. § 105). See also Blumberg, op. cit. n. 23, at ch. 10 (on substantive consolidation in the United States). Yet it has been observed that this doctrine is still vulnerable on account of its questionable statutory basis and the fact that it has not been 'formally embraced' by the US Supreme Court. See Douglas G. Baird, 'Substantive Consolidation Today', 47(1) *Boston College Law Review* (2005) pp. 5, 15). Using s. 271(1)(b) of the New Zealand's Companies Act 1993, the courts there can order that proceedings of two or more related companies will proceed together as if they were one company. In the English system, courts do not have an equivalent wide discretion to enact pooling orders or substantive consolidation. However, English courts expressed some flexibility in this regard in exceptional cases of extreme intermingling. See Re *BCCI* (No. 3) [1992] B.C.C. 1490; see also Re *Exchange Securities & Commodities Ltd* (In Liquidation) [1987] B.C.L.C. 425, in which the liquidator proposed a scheme under s. 425 of the English Companies Act 1985 that involved pooling all the assets and then distributing proceeds to creditors according to percentages agreed with them.

[26] That is, an organisation pattern in which the group represented itself (and acted) highly interdependently and in close integration (see *supra* n. 23 for the factors suggested in the literature for identifying the degree of integration within corporate groups).

[27] According to the US insolvency regime, intra-group obligations are terminated by the consolidation order. See Blumberg, op. cit. n. 23, at pp. 26 and 402.

[28] It may mean pooling all assets and debts together, ignoring the separateness between the companies comprising the group.

then assets can be pooled and the proceeds can be allocated to each company according to a compatible ratio and distributed to each company's creditors. In other circumstances, certain members can be initially excluded from the pool if the evidence suggests that they were not strongly integrated with the rest of the group. These optional pooling orders are 'partial' in that they only impose part of the means available to deal with commingled businesses or only apply it to a specific section of a group. However, it is not 'partial consolidation' in the sense that certain creditors are excluded from the pool.[29]

Another essential step to take here is to provide a test that is well-defined (and as objective as possible) for determining whether a pooling order should be applied. It seems that a factor such as certain creditors' subjective beliefs and their reliance on a single unit should not be decisive or sufficient in deciding on such a drastic tool.[30] On the other hand, a consideration of the extent of economic integration[31] (and thus the cost-efficiency of applying a pooling mechanism)[32] could serve as a reliable and unswerving factor in deciding about pooling orders. Nevertheless, the consideration of creditors' beliefs may still serve two different functions: (1) to reinforce the argument in favour of pooling when the objective test suggests the same;[33] and (2) to reveal a situation where the group actually

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[29] Partial consolidation (which aims to protect the interests of specific creditors or to affect an equitable remedy) is available under the US bankruptcy regime, but it is rare and considered impractical. See Blumberg, op. cit. n. 23, at p. 408. Under the New Zealand regime, the court may place conditions on a pooling order in accordance with its powers under s. 271(2) of the Companies Act 1993.

[30] Conversely, under the US bankruptcy regime, substantive consolidation may be allowed not only in cases where the financial affairs and businesses of the debtors are commingled, but also in cases where creditors of affiliate companies have dealt with these entities as a single economic unit and have not relied on their separate identities when extending credit. See, e.g., *Soviero* v. *Franklin National Bank* 328 F.2d 446 (2d Cir. 1964); *Union Sav. Bank* v. *Augie/Restivo Baking Company* (In re *Augie/Restivo Baking Co*) 860 F.2d 515 (2d Cir. 1988); In re *Owens Corning*, 419 F.3d (3d Cir. 2005). The conclusive factor is fairness. since substantive consolidation is an equitable tool. See In re *Snider Bros., Inc.* 18 B.R. 230, 234 (Bankr. D. Mass. 1982); *Chemical Bank N.Y. Trust Co.* v. *Kheel* 369 F.2d 845, 847 (2d Cir. 1966).

[31] The extent to which constituents of corporate groups were genuinely separate entities or rather altogether a *de facto* single entity; assessing such factors as whether there is commingling of accounts and difficulty in segregating individual assets and liabilities; the degree of intra-group transfers, the presence of separate books and accounts; and the representation to the public of the constituent companies as integral part of the group. See Blumberg, op. cit. n. 23, at pp. 696-699, and *supra* nn. 23 and 26.

[32] For instance, where close integration suggests that entangling the assets and debts of each entity will involve extensive burdens on the insolvency estate.

[33] Considering how creditors were actually doing business with the corporation. For instance, whether the creditors of a subsidiary negotiated with a holding company, supplied products to other members of the group or had other dealings with various parts of the business. They may have received a guarantee from the parent company, for example.

misled creditors to think that they would be able to recover from a financially stronger entity. It may thus suggest group liability, which will be discussed below.[34]

Another tool that can be used to facilitate an insolvency process of affiliates and may be less 'harmful' than the pooling mechanism (and thus less 'extreme') is 'procedural consolidation'.[35] This mechanism implies that only the procedural aspect of the insolvency is consolidated rather than the actual entities. Thus, a joint administration of the affiliated companies' proceedings is held. A particular court presides over all the cases and one office holder (or a group of joint administrators) is appointed for the various debtors. However, each company remains separate during the course of insolvency, and creditors recover their claims from the particular entity to which they belong. In many cases, it will be sufficient to link between the affiliates using this tool without completely ignoring the separation between the members. Here, too, economic integration should be a major factor in determining the need for this tool. Procedural consolidation should aim to address the case of integrated groups that will benefit from a unified process.[36] It is thus a relatively 'minor' type of mechanism that national laws can perhaps embrace more easily, as it does not involve a redistribution of rights and the corporate veil remains intact.

Shifting to cases in which there are also affiliates abroad, we can appreciate that even procedural consolidation is less 'obvious' and in any case should not be imposed automatically. It entails jurisdictional complications which may include the need to subject an entity to a different legal regime (than that of its country of incorporation)[37] or may introduce additional costs due to international communication.[38] Hence, if not truly justified, the outcome may be an additional burden of costs, complexities and efforts on the insolvency estate. If the group in question was integrated, however, it will be very problematic if no means for linking between its components becomes available. Without such links, it will undoubtedly

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[34] See *infra* s. 5.

[35] This tool is available in several national laws. In Canada and the United States, for example, it is counted as essential that corporate groups will be subjected to a joint administration (procedural consolidation) when a financially distressed group seeks to reorganise itself. See Blumberg, op. cit. n. 23, at pp. 402-405 (on procedural consolidation in the United States); J.S. Ziegel, 'Corporate Groups and Crossborder Insolvencies: A Canada-United States Perspective', 7 *Fordham J. Corp. & Fin. L.* (2002) pp. 367, 376 (explaining that procedural consolidation 'is almost de rigueur' in Canadian and US corporate groups' reorganisations).

[36] The level of integration will determine whether procedural or substantive consolidation should be applied. Accordingly, procedural consolidation will be suitable for the integrated corporate groups (see *supra* n. 23), while substantive consolidation will be appropriate in the strongly integrated corporate groups cases (see *supra* n. 26).

[37] If all the components' proceedings are to be placed in a certain jurisdiction subject to a single law to facilitate the joint administration. See Mevorach, loc. cit. n. 8, at p. 473.

[38] Ibid., at p. 466.

be futile to attempt a worldwide reorganisation or a global sale of assets in which different legal regimes are involved and entities are geographically spread across countries.[39]

Here the question is what sort of domestic policies may accommodate the case of a multinational corporate group that needs to be handled jointly in its insolvency. For instance, how should national laws deal with the critical issue of where to locate the joint proceedings if the case suggests a joint administration of a multinational group? Similarly, which court should supervise the entire process or handle the main process?

It is suggested that applying the concept of the 'centre of main interests' (COMI)[40] to the group as a whole can provide an adequate solution. The COMI of a group rather than a single debtor can help identify the proper jurisdiction to handle the main insolvency process. This idea can be promoted within domestic laws. However, it is extremely important that the test used to identify the COMI of a group accords with our second concept of 'clear and objective tests'.[41] Otherwise, taken from two different jurisdictions, this test may yield a different result. It is needless to say that, without consistency of results between jurisdictions, such a test will not be used within domestic regimes.

Ideally, domestic regimes should adopt a policy according to which local courts will avoid opening local proceedings against subsidiaries if they were actually managed via the group's centre located elsewhere. Furthermore, if subsidiaries had significant autonomy yet were integrated and coordinated together, local courts will subject local proceedings to the supervision of the main process handled in the group's centre. Moreover, they will provide that local courts should take account of the larger picture in their decision on commencing an insolvency process against a member of a corporate group (that has affiliates abroad) as well as the benefits for the stakeholders as a whole of having the process handled jointly.[42]

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[39] This can be demonstrated by the case of KPNQwest N.V. data communications group, where the global network (owned by separate entities) was sold in parts, which was significantly disadvantageous. See R. van Galen, 'The European Insolvency Regulation and Groups of Companies', INSOL Europe Annual Congress, 16-18 October 2003, Cork, Ireland, available at: <http://www.iiiglobal.org/country/european_union/Cork_paper.pdf>.

[40] The test used in the European Insolvency Regulation for ascertaining the international jurisdiction of a single debtor. See Art. 3(1) of the Regulation (see *supra* n. 6). The concept is also used in the UNCITRAL Model Law. See Art. 2(b) of the Model Law (see *supra* n. 6).

[41] The issue of the identification of the COMI for a corporate group requires serious consideration and is not within the scope of this paper. See I. Mevorach, 'Centralizing proceedings of pan-European corporate groups: a creditor's dream or nightmare?' *JBL* (2006) (considering aspects of fairness to creditors in the context of centralization of multinational corporate groups' proceedings).

[42] For an alternative approach, see the line of action taken initially by the US court in the case of Cenargo (In re *Cenargo International Plc* 294 B.R. 571 (Bankr. S.D.N.Y. 2003)). The court's readiness to open proceedings in the United States against an essentially English group

Another aspect of the idea of the COMI applied to the group scenario is worth mentioning. Obviously, a main feature of domestic approaches applying this idea is to define what is the COMI of a group or in other words to identify the 'proper venue'. In addition to providing a clear definition of a group's COMI, it would thus make sense to facilitate the identification of such a centre beforehand. Domestic regimes can provide rules that will assist in this area by casting a duty on every corporation to reveal whether it is a company which is integrated with other affiliates and (if this is indeed the case) where the centre of main interests of the group is located.

These ideas could also apply in the case of pooling orders for international groups of companies. Here it will be even more crucial to have the proceedings centralised or subjected to a single direction, using the above-mentioned mechanism of deferring to the court of main proceedings (of the group as a whole). At the very least, it should be provided within national laws that pooling is permissible in a multinational context and that courts should assist foreign representatives to achieve such mechanisms, for instance by means of agreements providing the main outlines and accompanied by implementation guidelines. Policies that encourage the ring-fencing of assets for the benefit of local creditors in situations where pooling is regarded as beneficial should be avoided.[43]

5. CONTRIBUTION AND SUBORDINATION ORDERS

The other category of linking tools deals specifically with the use (or misuse) of the corporate form with the result of prejudicing creditors in the context of insolvency. As mentioned above, this will typically concern an insolvent subsidiary and a solvent holding company. The above-mentioned pooling order can be used here,

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based on the fact that the debtor had only a bank account in the country was extensively criticised. See, e.g., S. Sandy and T. Richard, 'The Cenargo Case: A Tale of Conflict, Greed Contempt, Comity and Costs', *Insol World* (2003) pp. 33-35; L.M. LoPucki, *Courting Failure* (Ann Arbor, University of Michigan Press 2005) pp. 189, 191-193, 204-205. See also the recent decision of the European Court of Justice in *Eurofood IFSC Ltd* (ECJ) [2006] B.C.C. 397. Applying the European Insolvency Regulation, the European Court of Justice seems to embrace an 'entity' approach, according to which, at least as the starting position, the COMI is determined for each company (belonging to a group of companies) separately, for the purpose of opening main insolvency proceedings. However, interrelations with a parent company may be a contributory factor when considering whether the COMI is located in a place other than that of the subsidiary's registered office (see ibid., at paras. 26-37).

[43] An example of such an approach can be seen in the case of the BCCI banking group, where a substantial number of countries, including the United States, insisted on giving priority to local claims against local assets despite the fact that the group's funds were extensively commingled. See J.L. Westbrook and J.S. Ziegel, 'NAFTA Insolvency Project', 23 *Brook. J. Int'l L.* (1997-1998) p. 8.

too.[44] However, if a solvent parent is to be responsible for its insolvent subsidiary's debts, it may be unwise to drag it into the insolvency process. There may be more appropriate mechanisms to use here. One such mechanism is the 'contribution order' provided under New Zealand's legal regime.[45] This mechanism attempts to tackle the scenario of related companies in insolvency and the possibility of unfair behaviour within the group. Accordingly, it gives a wide discretion to courts to hold a related company liable for the debts of a company being wound up in circumstances of involvement with or misconduct towards the debtor in question.[46] To this end, the court should consider whether it is just and equitable, as well as desirable for the protection of creditors, to impose group liability.[47]

However, bearing in mind our initial objective to identify some proper standards for domestic policies and to accommodate international cases, we should also consider how to impose clear boundaries and safeguards for the implementation of such a mechanism.

Once again, we return to the need for a clear and objective test to accompany such tools and the need to be cautious when using it. Indeed, the wide discretion given to the court under Section 271(1)(a) of the New Zealand's Companies Act 1993 is tempered by four guidelines that the court should follow when deciding on a contribution order, yet these may be still too vague for our purposes. For instance, it is not sufficiently clear what will constitute misconduct of the related company towards the creditors of the company in liquidation.[48] The forth guideline permitting the court to consider 'any other matters as it thinks fit' is particularly open to interpretation.

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[44] The substantive consolidation provided in the US regime is also available between a debtor and a non-debtor. See In re *1438 Meridian Place, N.W., Inc.*, 15 Bankr. 89 (Bankr. D.D.C. 1981); In re *Crabtree*, 39 Bankr. 718 (Bankr. E.D. Tenn. 1984); Blumberg, op. cit. n. 23, at pp. 439-440.

[45] See s. 271(1)(a) of the New Zealand's Companies Act 1993.

[46] It is at the court's discretion to order that the related company pay the debtor's liquidator all or part of its debts when it is just and equitable to do so (ibid.).

[47] Conversely, it seems that the English approach to the issue of misbehaviour within a corporate group gives somewhat limited protection to creditors. Although the 'wrongful trading' statutory remedy (s. 214 of the English Insolvency Act 1986) can potentially be used to impose group liability (applying the concept of 'shadow director' in s. 214(7)), English courts are essentially reluctant to develop a 'group enterprise law' and tend to adhere to the entity doctrine (as expressed in *Adams* v. *Cape Industries plc* [1990] B.C.L.C. 479). However, particular transactions among group members that may be regarded as 'vulnerable' can be attacked using the avoidance provisions such as s. 238 of English Insolvency Act 1986 (transactions at an undervalue) or s. 239 (preferences) and the concept of 'connected persons' incorporated therein.

[48] One of the guidelines under this section. The court should also consider the extent to which the related company took part in the management of the company in liquidation and whether the circumstances that gave rise to the liquidation of the company are attributable to the actions of the related company.

These guidelines can be used as a starting point to which more specified rules may be added, thus explicitly providing what kinds of abusive or unfair behaviour can form the basis for a contribution order. Definitions and suggestions provided in legal literature can be used for this purpose.[49] The idea is to formulate the way in which the court will assess the conduct of the related company. As a consequence, courts will be equipped with further guidelines on the circumstances in which it would be more appropriate to use a contribution order or a pooling order and on how to deal with conflicts of interest of creditors (those of the subsidiary and those of the contributory parent) in this regard.

Similar guidelines can then be used for determining whether a contributory party's claims should be subordinated to those of external creditors (equitable subordination), narrowing down the wide discretion that may be given to courts under certain jurisdictions using this tool.[50]

It is important to enable the use of tools such as contribution and subordination orders for cases involving foreign affiliates (i.e., in the case of multinational corporate groups). Otherwise, corporate groups can divert proceeds and form subsidiaries for the sole purpose of manipulating creditors, cherry picking those jurisdictions that will not provide the needed remedy to creditors. Therefore, apart from being available in the national system, these tools should also have extraterritorial effect, and there should be provisions similarly recognising contribution or subordination orders issued against local members (e.g., a local parent).

The idea of having the main proceedings handled by the court where the COMI of the corporate group or the specific subsidiary is located is useful here too. This insolvency court should be authorised to issue contribution or subordination orders, and its jurisdiction should be extended to reach foreign affiliates, as its authority should include the handling of all insolvency-related matters, including group liability.

6. SUMMARY

In order to promote the economic efficiency, fairness and integrity of insolvency systems, it should be promoted that a variety of mechanisms that will make it

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[49] One very useful approach delineates four categories of abuse as a basis for group liability in the context of insolvency. See A. Muscat, *The Liability of the Holding Company for the Debts of its Insolvent Subsidiaries* (Aldershot, Dartmouth 1996) ch. 5, 6, 7 and 8.

[50] Under the US bankruptcy regime (11 U.S.C.A. § 510(c)), US courts are permitted to impose subordination of claims on equitable grounds (see, e.g., *US* v. *Noland*, 517 U.S. 535 (1996)). Thus, courts are allowed to inquire into the conduct of the parties and the nature of the financial arrangement which gave rise to the debt and subordinate the debt to the claims of the external creditors. Such subordination of intra-company claims may be ordered in a wide variety of circumstances where equitable principles so require. See Blumberg, op. cit. n. 23, at ch. 3.

possible to link affiliates in insolvency cases are embraced under domestic laws. As noted above,[51] this can be done by international institutions like UNCITRAL, using instruments such as the UNCITRAL legislative guide. However, we should proceed with caution in recommending such tools, respecting the corporate form concept as a starting point. We should also aim to have a standardised set of rules so as to promote harmonisation and the likelihood that judgments on such matters will be recognised and enforced by national courts. Otherwise, even if various legal regimes have implemented the suggested approaches, it will be unlikely that the outcomes of cases in different legal regimes will be consistent. In addition, domestic laws should provide remedies and promote those concepts that can assist in effectively handling international insolvency cases. Using these guidelines to construct the various linking mechanisms will help in achieving effective tools that are broadly accepted and provide an appropriate platform for dealing with corporate groups in their insolvencies.

[51] See *supra* n. 13 and accompanying text.