

# CROSS-BORDER INSOLVENCY LAW AND MULTINATIONAL ENTERPRISE GROUPS: JUDICIAL INNOVATION AS AN INTERNATIONAL SOLUTION

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## INTRODUCTION

Multinational businesses by definition operate in multiple jurisdictions and therefore are subject to regulation under a diverse array of national laws. When such businesses become insolvent, their insolvencies are subject to domestic legal rules and a multitude of national courts.<sup>1</sup> Domestic insolvency laws were designed by nation states in accordance with their own unique political compromises and social expectations. These domestic laws reflect bargains between creditor and debtor protection on the one hand and the achievement of wider social goals on the other. In the international insolvency context, creditors compete in order to maximize their private benefit to the exclusion of others. The result has been summed up by one author as triggering “diverse and uncoordinated legal proceedings in various countries connected to the affairs of [a multinational] enterprise.”<sup>2</sup> Inevitably, as private

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1. See *Explanatory Memorandum, Cross-Border Insolvency Bill 2007* (Cth) 3 (Ausl.); IAN F. FLETCHER, *INSOLVENCY IN PRIVATE INTERNATIONAL LAW* 5–6 (2d ed. 2005) (“Many different factors are capable, either singly or in combination, of imparting a cross-border dimension to a case of insolvency. The debtor may have had dealings with one or more parties from other countries, or may own or have interests in property not all of which is exclusively within the jurisdiction of a single state. Liabilities may be owed to parties whose forensic connections are predominantly with a different country to that with which the debtor is associated; or the relevant obligations may be governed by foreign law, may have been incurred outside the debtor’s home country, or may be due to be performed abroad.”). See also ROY GOODE, *PRINCIPLES OF CORPORATE INSOLVENCY LAW* 780 (4th ed. 2011) (explaining the characteristics of international insolvency).

2. Hannah L. Buxbaum, *Rethinking International Insolvency: The Neglected Role of Choice-of-Law Rules and Theory*, 36 *STAN. J. INT’L L.* 23, 23 (2000).

actors compete to secure their interests via a multiplicity of proceedings, net costs rise.<sup>3</sup> The potential scale of such expenses is illustrated by the recent insolvency of Nortel Networks where the legal costs alone exceeded a billion dollars, depriving creditors and other stakeholders of recovering this amount.<sup>4</sup>

A solution to these problems would be to subject the insolvency of multinational enterprises to a single proceeding with the responsibility for disbursing assets to all claimants. An alternative to this universalist view,<sup>5</sup> would be for each nation to apply its own laws within its own jurisdiction to the assets of the insolvent debtor and distribute the proceeds to local creditors. This is referred to as territorialism,<sup>6</sup> a system characterized by a multiplicity of proceedings, resulting in inefficiencies.<sup>7</sup> Insolvency law is not subjected to a mandatory universal harmonization process and there is no international law that can limit diverse and uncoordinated proceedings. Rather, the international legal landscape is characterized by an incomplete patchwork of national laws that try to accommodate cross-border insolvencies.

Beyond the general problems encountered in the insolvency context, the insolvency of corporate groups present even greater

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3. See U.N. COMM'N ON INT'L TRADE LAW (UNCITRAL), UNCITRAL MODEL LAW ON CROSS-BORDER INSOLVENCY WITH GUIDE TO ENACTMENT 20 (2012), <https://www.uncitral.org/pdf/english/texts/insolven/1997-Model-Law-Insol-2013-Guide-Enactment-e.pdf>. (“[N]ational insolvency laws have by and large not kept pace with the trend, and they are often ill-equipped to deal with cases of a cross-border nature. This frequently results in inadequate and inharmonious legal approaches, which hamper the rescue of financially troubled businesses, are not conducive to a fair and efficient administration of cross-border insolvencies, impede the protection of the assets of the insolvent debtor against dissipation and hinder maximization of the value of those assets.”).

4. Jim Christie, *Slim Odds for Clawback of Attorneys' Fees in Nortel Bankruptcy*, REUTERS (May 28, 2015), <http://www.reuters.com/article/2015/05/28/bankruptcy-nortel-idUSL1N0YJ0J120150528>; Janet McFarland, *Judges Rip Squabbling Nortel Lawyers*, GLOBE & MAIL (May 14, 2015), <https://secure.globeadvisor.com/servlet/ArticleNews/story/gam/20150514/RBSWNORTELLAWYERS>.

5. Jay Lawrence Westbrook, *A Global Solution to Multinational Default*, 98 MICH. L. REV. 2276, 2292–93 (2000).

6. Samuel L. Bufford, *Global Venue Controls Are Coming: A Reply to Professor LoPucki*, AM. BANKR. L.J. 105, 108 (2005).

7. It is arguable that territorialism actually reflects the expectations of creditors and debtors because the lender is able to factor in the risks better within the local insolvency law where the assets are located. Kent Anderson, *The Cross-Border Insolvency Paradigm: A Defense of the Modified Universal Approach Considering the Japanese Experience*, 21 U. PA. J. INT'L ECON. L. 679, 698 (2000) (“[T]he territorial approach arguably better reflects the fact that global businesses are largely organized by independent incorporation in each country where the debtor is doing business.”). See Jay Lawrence Westbrook, *Theory and Pragmatism in Global Insolvencies: Choice of Law and Choice of Forum*, 65 AM. BANKR. L.J. 457, 460 (1991).

complexities.<sup>8</sup> In these situations, to limit liability, corporations conduct business as part of a group of companies often structured under the control of a parent, with complex cross-holdings amongst themselves.<sup>9</sup> This type of structure can effectively remove the parent from liability for the misdeeds or debts of its subsidiaries.<sup>10</sup>

The strong sense of inviolability attached to separate corporate legal personality presents little difficulty when all group members are solvent. However, when one member of a corporate group becomes insolvent, the laws governing the transactional interactions between corporate debtors and creditors are disturbed. Certain transactions that had, until the point of insolvency, enjoyed the enforceability afforded under the laws of contract, are no longer enforceable or can become voidable. Unfair preferences, uncommercial or insolvent transactions, unfair loans or unreasonable director-related transactions entered into by the company and that would remain undisturbed before the date of insolvency, become voidable at the date of insolvency.<sup>11</sup> Similarly, in insolvency matters, payments are made to some categories of creditors, including employees, in priority to other creditors.<sup>12</sup> As a result, secondary creditors may receive less than what they were entitled to under their contracts with the company.<sup>13</sup> In situations of corporate insolvency, on a normative basis, the certainty inherent in normal contractual relations between creditors and corporations is subverted for the benefit of some creditors.<sup>14</sup>

On an international scale, the globalization of business means that multinational enterprises operate in a number of countries through companies incorporated under local laws. These companies might be tightly tethered to a parent company or loosely related to other entities spread across countries and continents without significant centralized control. Given such circumstances, there are no present global laws to regulate the insolvency of groups of corporations where one or more entities within the

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8. See IRIT MEVORACH, *INSOLVENCY WITHIN MULTINATIONAL ENTERPRISE GROUPS* 127–29 (2009) [hereinafter MEVORACH, *INSOLVENCY*].

9. *Id.* at 10–15.

10. Phillip I. Blumberg, *Limited Liability and Corporate Groups*, 11 J. CORP. L. 573, 574–75 (1986).

11. See, e.g., *Corporations Act 2001* (Cth) s 588FE (Austl.).

12. *Id.* s 556 (prioritizing payments to employees of insolvent companies over other unsecured creditors).

13. *Id.* (listing priority payments in the *Corporations Act*).

14. See Lucian Arye Bebchuk & Jesse M. Fried, *The Uneasy Case for the Priority of Secured Claims in Bankruptcy*, 105 YALE L.J. 857, 861–62 (1996).

group are situated in different countries.<sup>15</sup> Separate proceedings have to be commenced in each jurisdiction for each group member.<sup>16</sup> Limited exceptions may apply, for example, if all parties consent to include more than one group member, the parties are 'closely economically integrated' or if, as in reorganization plans, there is 'special legal relevance' in considering the group as a single entity.<sup>17</sup>

The procedural and conflict laws of the states within which a corporation is incorporated will invariably apply. These divergent national laws generate uncertainty for parties; consequently, they result in inefficiency in the form of transaction costs.<sup>18</sup> In accordance with established corporate law,<sup>19</sup> the separate companies within a corporate structure are treated as separate legal entities subject to the insolvency laws applicable in their own jurisdiction.<sup>20</sup> As a result, the rights of foreign and local creditors must be considered; now on a global basis. Insolvency professionals, lawyers, and courts must determine the assets available to distribute, and how to distribute those assets to the creditors of a single company in the jurisdiction of the proceedings or on a global basis to the creditors of the group as a whole. This decision presents several difficulties. First, a determination must be made as to whether the entities operated with tight separation and maintained separate accurate records of the numerous inter-company transactions, or whether they operated as a closely knit enterprise with a flexible approach to inter-company transactions. Second, the legal status of those transactions and respective claims and liabilities *inter se* must be ascertained and apportioned. Third, the expectations of the creditors—whether their extension of credit was tied to the assets of the

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15. See FLETCHER, *supra* note 1, at 7.

16. *Id.* at 6.

17. U.N., Comm'n on Int'l Trade Law (UNCITRAL), Legislative Guide on Insolvency Law, Part Three: Treatment of Enterprise Groups in Insolvency, 20–21, U.N. Doc. A/CN.9/WG.V/WP.82/Add.1 (2012) [hereinafter Legislative Guide Part Three].

18. As UNCITRAL Working Group V noted, "the insolvency of one group member may cause financial distress in other members or in the group as a whole, because of the group's integrated structure, with a high degree of interdependence and linked assets and debts between its different parts. In those circumstances, it might often be the case that the insolvency of several or many group members would lead inevitably to the insolvency of all members (the "domino effect") and there may be some advantage in judging the imminence of the insolvency by reference to the group situation as a whole or to coordinate the consideration with respect to multiple members." *Id.* ¶ 4.

19. See Irit Mevorach, *Towards a Consensus on the Treatment of Multinational Enterprise Groups in Insolvency*, 18 CARDOZO J. INT'L & COMP. L. 359, 374–75 (2010) [hereinafter Mevorach, *Towards a Consensus*].

20. See *id.* at 375–76.

local entity or the entire enterprise—must be evaluated. Finally, the optimal method to achieve the survival of the group or to dispose of the enterprise to maximize value must be assessed. While this is not an exhaustive list of questions to be answered, it provides an indication of the complex questions presented in such insolvency events.

Current insolvency laws and, more particularly, laws relating to cross-border insolvencies are inadequate when companies within a group or whole groups of companies become insolvent. While some progress has been made in global efforts to resolve cross-border insolvencies of single entities, such as through the UNCITRAL Model Law on Cross-border Insolvency,<sup>21</sup> discussions about global approaches to the cross-border insolvency of corporate groups are still in their infancy. Organizations developing responses to these problems such as UNCITRAL Working Group V are still wrestling with the complex web of normative, substantive, and procedural problems that beset the cross-border insolvency of groups. A global ‘law’ in this area may still be a long way off.<sup>22</sup>

While an international solution is in progress, a few nations have also made attempts to address these issues. In Australia, recent amendments to the Commonwealth Corporations Act 2001<sup>23</sup> provide some limited exceptions to the separate legal entity doctrine relating to national groups of companies that might have wider implications.<sup>24</sup> In some circumstances, parent companies can be held liable for the debts of subsidiaries or the assets of a group of companies in administration, and liquidation can be pooled to meet the debts of a single entity within the group under the Act.<sup>25</sup> These amendments have gone a small way in ameliorating the

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21. U.N. COMM’N ON INT’L TRADE LAW, UNCITRAL MODEL LAW ON CROSS-BORDER INSOLVENCY WITH GUIDE TO ENACTMENT AND INTERPRETATION, U.N. Sales No. E.14.V.2 (1997). The Model Law was adopted in the United States as Chapter 15 of the Bankruptcy Code and in Australia under the *Cross-Border Insolvency Act 2008* (Cth) (Model Law). The status of the law in various countries is available at: *Status: Model Law on Cross-Border Insolvency* (1997), U.N. COMM’N ON INT’L TRADE L., [http://www.uncitral.org/uncitral/en/uncitral\\_texts/insolvency/1997Model\\_status.html](http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency/1997Model_status.html) (last visited Sept. 22, 2015).

22. See, e.g., Mevorach, *Towards a Consensus*, *supra* note 19; Irit Mevorach, *Cross-Border Insolvency of Enterprise Groups: The Choice of Law Challenge*, 9 BROOK. J. CORP. FIN. & COM. L. 107, 107 (2014).

23. The Corporations Act 2001 was amended by *Corporations Amendment (Insolvency) Act 2007* (Cth) (Austl.) to provide for pooling determinations and pooling orders.

24. See *infra* Part IV.A discussion of recommendations in the UNCITRAL Legislative Guide.

25. See *Corporations Act 2001* (Cth) pt 5.6 div 8 (Austl.) (pooling); *Corporations Act 2001* (Cth) pt 5.7B div 5 (Austl.) (liability of parent companies).

issues relating to insolvency of groups of companies.<sup>26</sup> In general, local attempts to 'lift or pierce the corporate veil' or other statutory responses are inadequate for the complex task of resolving cross-border insolvencies when members of the groups of companies are registered in different jurisdictions.<sup>27</sup>

National law approaches to these problems include, at a substantive level, piercing the corporate veil and pooling assets, and at a procedural level subjecting all members of the corporate group to a single consolidated set of proceedings in one jurisdiction.<sup>28</sup> These approaches are rarely used and are of limited effect. An alternative and more comprehensive approach to multinational group insolvency—proposed by scholars like Blumberg<sup>29</sup>—would be to treat the group as a single enterprise. At present, the circumstances for treating the entities as one enterprise must be determined on a case-by-case basis, resulting in uncertainty. Not only does enterprise law *disturb* the doctrine of separate legal entity,<sup>30</sup> but it also raises the debate between the competing normative arguments for unity and universalism on the one hand, and territoriality on the other, as discussed in Section IV C below. As each country struggles to respond to these issues, they continue to be the focus of international efforts by bodies such as the United Nations Commission on International Trade Law (UNCITRAL)<sup>31</sup>

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26. See, e.g., *Corporations Act 2001* (Cth) ss 588V, 588W (Austl.) (in some limited circumstances, a holding company can be held liable for the debts owed to unsecured creditors of the subsidiary). See also *infra* discussion below regarding the pooling determinations and pooling orders that can be made under Part 5.6, Division 8. The introduction of these provisions followed recommendations to that effect in the Harmer Report, THE LAW REFORM COMMISSION, REPORT NO. 45: GENERAL INSOLVENCY INQUIRY (Australian Government Publishing Service 1988) [hereinafter HARMER REPORT] and the Companies & Securities Advisory Committee (CASAC), *Chapter 6: Liquidation of Group Companies*, in CORPORATE GROUPS FINAL REPORT (2000) [hereinafter CASAC Report].

27. See *infra* Part II; MEVORACH, INSOLVENCY, *supra* note 8, at 62–63; Mevorach, *Towards a Consensus*, *supra* note 19, at 362.

28. See GOODE, *supra* note 1, at 788–89.

29. See Irit Mevorach, *Is the Future Bright for Enterprise Groups in Insolvency? An Analysis of UNCITRAL's New Recommendations*, in INTERNATIONAL INSOLVENCY LAW 371–74 (Paul Omar ed., 2013) [hereinafter Mevorach, *Is the Future Bright*]; Phillip I. Blumberg, *The Corporate Entity in an Era of Multinational Corporations*, 15 DEL. J. CORP. L. 283, 285–88 (1990) [hereinafter Blumberg, *The Corporate Entity*].

30. See *infra* Part IV.A.

31. UNCITRAL is “[t]he core legal body of the United Nations system in the field of international trade law. A legal body with universal membership specializing in commercial law reform worldwide for over 40 years, UNCITRAL’s business is the modernization and harmonization of rules on international business.” *About UNCITRAL*, UNITED NATIONS COMM’N ON INT’L TRADE L., [http://www.uncitral.org/uncitral/en/about\\_us.html](http://www.uncitral.org/uncitral/en/about_us.html) (last visited Sept. 22, 2015).

and the European Union to create a more efficient and global response.

Against this backdrop of uncertainty and absence of international harmonization, this Article argues that courts confronting the effects of multinational enterprise insolvency must undertake a pragmatic incursion into the separate entity doctrine. This argument is premised on gaps in the current Model Law, which confers significant discretion on the courts. Our research shows that courts have fashioned innovative solutions to fill the gaps and that greater recognition of the legitimacy of these judicial incursions into the separate entity doctrine would facilitate the reduction of transaction costs in the case of multinational group insolvencies.<sup>32</sup> One form of recognition would be a binding convention adopted by UNCITRAL, expressly conferring such authority on courts where the enterprise group is essentially functioning as a single commercial unit. This would require a showing of identified criteria whereby a court would be able to determine that the inherent separateness of the corporate structure should be disregarded and the group regarded as one. This argument is bolstered by events in the recent landmark cases, including the 2015 decisions in *Nortel Networks*.<sup>33</sup>

This Article is organized as follows: Section I outlines the arguments for separate legal personality of corporations and the difficulties posed by this doctrine in the context of group companies. Section II delineates how Australia has grappled with these issues at a national level under the Corporations Act and the common law. Section III provides a brief overview of the problems presented by the insolvency of multinational enterprise groups. Section IV outlines current international efforts to tackle the problem. Section V advances our normative argument for reform with reference to the recent decisions in the landmark insolvency of *Nortel Networks*. Section VI concludes.

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32. The use of court-sanctioned innovative solutions both *ex ante* and *ex post* as a governance mode for certain transactions such as cross-border insolvencies of multinational enterprises, supports the transaction cost economics approach of Oliver Williamson and would, we argue, have the effect of increasing transaction cost efficiencies in those circumstances.

33. *Re Nortel Networks Corp.*, (2015) CanLII 2987 (Can. Ont. Sup. Ct. J.).

## I. SEPARATE LEGAL IDENTITY OF CORPORATIONS

The notion that a corporation has a separate legal personality is a bedrock feature of corporate law.<sup>34</sup> In *Sutton's Hospital*,<sup>35</sup> Sir Edward Coke summarized the elements necessary to establish a corporation and noted that, unlike a person, corporations “cannot commit treason, nor be outlawed, nor excommunicate, for they have no souls.”<sup>36</sup> Thus companies have separate legal personality but have “no body to be kicked” and “no soul to be damned”<sup>37</sup> and hence provide an effective legal insulation between shareholders and creditors.

The English case of *Salomon v. Salomon & Co. Ltd.*<sup>38</sup> established the doctrine of separate legal personality.<sup>39</sup> It stated that a corporation was a separate legal entity from its managers and shareholders.<sup>40</sup> This doctrine provided certainty in business dealings with corporations, allowing those who dealt with corporations to rely on the statutory obligations of the corporation and its rights against a legal person.

Around the same time that courts were reinforcing the separate legal entity doctrine in *Salomon*, the liability of those holding shares in a corporation was limited by legislation.<sup>41</sup> Since then, this combination of separate legal existence and limited liability of corpora-

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34. See *infra* discussion following.

35. Case of Sutton's Hospital (1612) 77 Eng. Rep. 960 (KB).

36. *Id.* at 973.

37. John C. Coffee, Jr., “No Soul to Damn: No Body to Kick”: An Unscandalized Inquiry into the Problem of Corporate Punishment, 79 MICH. L. REV. 386, 386 (1981) (quoting Edward, First Baron Thurlow).

38. *Salomon v. Salomon & Co. Ltd.* [1897] AC 22 (HL) 30.

39. But see Rob McQueen, *Life Without Salomon*, 27 FED. L. R. 181, 188 (1999) (arguing that, at least by 1858 and well before the time of the decision in *Salomon* in 1897, there was general acknowledgement that the limited liability company structure would apply to protect one person companies as well as large corporations). McQueen notes that the *Law Times* on 25 March 1858 reported that the Companies Acts of the time had effectively enacted that “a man shall not pay his debts, perform his contracts or make reparation for his wrongs.” *Id.*

40. Lord MacNaghten opined that “[t]he company is at law a different person altogether from the subscribers to the memorandum; and, though it may be that after incorporation the business is precisely the same as it was before, and the same persons are managers, and the same hands receive the profits, the company is not in law the agent of the subscribers or trustee for them. Nor are the subscribers as members liable, in any shape or form, except to the extent and in the manner provided by the Act.” *Salomon v. Salomon & Co. Ltd.* [1897] AC 22 (HL) 51.

41. Phillip I. Blumberg, *The Transformation of Modern Corporate Law: The Law of Corporate Groups*, 37(3) CONN. L. REV. 605, 607 (2005) [hereinafter Blumberg, *Transformation*] (“With the Industrial Revolution and the increasing need for more corporate capital to exploit the burgeoning technological developments of the time, this jurisprudential concept of the separate corporate personality was strongly reinforced by the political decision

tions has proven to be an effective insulant from company liability for investors. Coevally, English corporations were permitted to invest in other corporations.<sup>42</sup> Combining these ideas of separate entity doctrine, limited liability, and corporate ability to invest in other companies, groups of companies today proliferate in the global economy.<sup>43</sup>

### A. *Economic Justification for Limited Liability*

The use of the limited liability doctrine creates a veil behind which corporations transact—without recourse to the assets of individual investors beyond their investment in the corporation and officers who perform the daily work of the corporation.<sup>44</sup> The economic justification for treating a corporation as a separate legal entity with limited liability is strong. However, it should remain open to examination. Blumberg states that “[l]imited liability on the whole seems to serve a desirable function in creating appropriate incentives for widespread investor participation in the equity ownership of major corporate enterprises.”<sup>45</sup> Easterbrook and Fischel refer to the efficiencies to be had in utilizing the limited liability of *publicly-held* corporations in marshaling the “specialized skills of multiple agents and large amounts of capital.”<sup>46</sup> These have been summarized as “principles of economic efficiency” in support of limited liability.<sup>47</sup>

These are strong economic incentives as they apply to *publicly-held* companies, where individual shareholders are removed from the decision-making processes of the company.<sup>48</sup> However, Blumberg argues that these types of reasons “ignore or give only summary consideration to the special problems presented by the subsidiary companies of a corporate group in which the share-

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in the early nineteenth century of legislatures to provide limited liability for shareholders.”).

42. See Blumberg, *Limited Liability*, *supra* note 10, at 608 (citing *In re Barned’s Banking Company* (1867) 3 L.R. 105, 112–13 and *In re Asiatic Banking Corporation* (1869) 4 L.R. 252, 257).

43. See Blumberg, *Transformation*, *supra* note 41, at 606; MEVORACH, *INSOLVENCY*, *supra* note 8, at 5.

44. See Frank H. Easterbrook & Daniel R. Fischel, *Limited Liability and the Corporation*, 52 U. CHI. L. REV. 89, 109–11 (1985).

45. Blumberg, *Limited Liability*, *supra* note 10, at 622.

46. FRANK H. EASTERBROOK & DANIEL R. FISCHEL, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 41 (1991).

47. Ian M. Ramsay, *Holding Company Liability for the Debts of an Insolvent Subsidiary: A Law and Economics Perspective*, 17 U.N.S.W. L.J. 520, 535 (1994).

48. See Easterbrook & Fischel, *supra* note 44, at 89–109; Blumberg, *Limited Liability*, *supra* note 10, at 611–23.

holder is the parent or another component company of the group, not the ultimate investor.”<sup>49</sup> Therefore, the economic justifications for separate personality might not apply, or might not have as strong of a justification, in the case of corporate groups.<sup>50</sup>

### B. *Corporate Groups*

Regardless of the purpose for which a related entity is formed, there are several practical effects that flow from corporations' treatment as separate legal entities: debts, liabilities, contractual obligations, and intellectual property rights are confined to each separate entity, and dividends are paid out of profits earned by the entity and not the group.

In 2014, 2.12 million companies were registered in Australia.<sup>51</sup> A study of 1,526 companies listed on the Australian Stock Exchange (ASX) in 2010 showed that, 88 percent of companies were structured as part of a corporate group but that most listed companies (77 percent) had fewer than 10 controlled entities.<sup>52</sup> As an example of the pervasive, international nature of this phenomenon, a separate report prepared by the Australian Tax Justice Network noted that, in 2013, “BHP Billiton<sup>53</sup> had 462 subsidiaries in 49 countries . . . [and] Rio Tinto<sup>54</sup> had 926 subsidiaries in 71 countries.”<sup>55</sup> It could be argued that these companies are not truly ‘of’ one country, but instead belong to the world.<sup>56</sup> Given this land-

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49. Blumberg, *Limited Liability*, *supra* note 10, at 623.

50. *Id.* at 626. (“The extension of layers of limited liability to the tiers of subsidiaries within corporate groups lacks most of the theoretical justification that has been advanced in defense of the rule. Accordingly, reconsideration of the rule is in order, particularly since application of limited liability to corporate groups appears to have been accidental.”).

51. AUSTRAL. SEC. & INVS. COMM'N, ANNUAL REPORT 6 (2013–2014), <http://download.asic.gov.au/media/2227467/asic-annual-report-2013-14.pdf>.

52. Sandra van der Laan & Graeme Dean, *Corporate Groups in Australia: State of Play*, 53 AUSTRAL. ACCT. R. 121, 127–28 (2010).

53. BHP Billiton is an Australian company but is dual listed on the Australian and New York Stock Exchanges as BHP Billiton Limited and BHP Billiton Plc.

54. Rio Tinto plc, is a London and New York Stock Exchange listed company, and Rio Tinto Limited is an Australian company listed on the Australian Stock Exchange.

55. THE TAX JUSTICE NETWORK, WHO PAYS FOR OUR COMMON WEALTH? TAX PRACTICES OF THE ASX 200 (2013), <http://bit.ly/UVasxtax>.

56. For example, what had been an iconic Australian company for many years, James Hardie & Coy Pty Ltd., changed its name to Amaca Pty Ltd. to avoid the stain of its damaging asbestos liability in Australia. Similarly, the well-known Hardie-Ferodo Pty Ltd. changed its name to the equally bland Amaba Pty Ltd. and even more blatantly, the former ultimate group holding company James Hardie Industries Limited is now known as ABN 60 Pty Ltd. and was removed from the James Hardy Group altogether pursuant to a scheme of arrangement. James Hardie Industries NV, a foreign company incorporated in the Netherlands and registered in Australia as such under the Corporations Act is now the

scape and proliferation of corporate groups, a global solution is needed.

Why is there such a proliferation of corporate groups in Australia and elsewhere? Eisenberg believes that “[w]ith few if any exceptions, wholly owned groups exist only as a response to legal rules.”<sup>57</sup> Some of those responses include tax advantages of distributing profits and losses between group members and compliance with procedural requirements when a company wishes to trade in another country. Other groups incorporate subsidiaries to avoid prohibitions on monopolies while others, still, seek the protection of a related entity to shield them from liability.<sup>58</sup> Ramsay also proposes a number of legal and economic arguments for why a company might establish subsidiaries and form a corporate group.<sup>59</sup> These advantages also have concomitant disadvantages, which, when considered, might provide reasons for moderating its use or as an argument for looking behind the group structure.

Hadden delineates six broad categories of ‘manipulation and abuse’ of group structures, through both control and integrated financing: 1) the use of group control, such as interlocking shareholdings and directorships to strengthen the position of incumbent managers; 2) integrated financing techniques such as the ease of transfer of assets and liabilities between companies within the group to conceal the true financial position of individual companies; 3) preference given to the interests of group shareholders and directors over those of minority subsidiary; 4) integrated financing techniques that allow maximum profit to be generated in low taxing jurisdictions; 5) separate companies that create spe-

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ultimate holding company of the James Hardy Group and is free of any liability for asbestos exposure of the Australian companies. To use the vernacular, this was seen as very “un-Australian.” Also compare the concerns still emanating from UNCITRAL Working Group V, among others, about the ability of companies to shift their COMI to any preferred jurisdiction seemingly at will to reduce their liability. These are but small examples of the international nature of modern day corporations.

57. Melvin Aron Eisenberg, *Corporate Groups*, in *THE LAW RELATING TO CORPORATE GROUPS* 4 (Michael Gillooly ed., 1993).

58. *Id.* at 5 (arguing that “wholly owned subsidiaries are created for the purpose of limiting or circumventing the rights of corporate creditors or shareholders. In some cases, the purpose of the wholly owned subsidiary is to insulate the parent corporation, as well as the parent’s shareholders, from liability arising out of business activity that the parent economically conducts. In these cases, the function of the subsidiary is to deny to third parties claims they would have if the subsidiary had not been formed.”).

59. See Ramsay, *supra* note 47, at 533–34 (including to “reduce the exposure of its assets” or to acquire a business in partnership with an individual or another company and not give up its own company rights. Similarly, a corporation might establish subsidiaries to ring-fence outside investment in part only of its business or to give greater flexibility with respect to debt financing).

cific operations and use integrated financing techniques to avoid liability to creditors; and 6) complex group structures used to avoid regulatory measures against, for example, monopolies and mergers or health and safety regulations.<sup>60</sup>

The problems listed by Hadden are in some circumstances merely another way of looking at the advantages outlined by Ramsay. For example, the benefit of operating the business by means of a corporate group with lower taxation (noted by Ramsay) is painted by Hadden as “[avoiding] taxation by ensuring that maximum profit is generated in forums or in jurisdictions which attract low levels of tax.” Similarly, avoiding prohibitions on monopolies can be seen as either a benefit (to the corporation) or a detriment (to a society that prizes competition).

Lord Justice Templeman succinctly highlighted the landscape within which these issues arise in *Re Southard & Co. Ltd.*:<sup>61</sup>

If one of the subsidiary companies . . . turns out to be the runt of the litter and declines into insolvency . . . the parent company and the other subsidiary companies may prosper to the joy of the shareholders without any liability for the debts of the insolvent subsidiary . . . the unsecured creditors wish the finances of the company and its relationship with other members of the group to be narrowly examined.<sup>62</sup>

In the 40 years since *Re Southard* was decided, and the 20 years since Hadden detailed the problems associated with corporate groups,<sup>63</sup> the internationalization of corporate groups has increased dramatically. When a group's structure is organized ex ante, the group will be structured to distance the parent or other companies from liability in the case of insolvency.<sup>64</sup> To mix a metaphor from *Re Southard*, the subsidiary becomes not the runt of the litter but the sacrificial lamb; consequently, the “group structure

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60. Tom Hadden, *The Regulation of Corporate Groups in Australia*, 15 U.N.S.W. L.J. 61, 65 (1992).

61. See *Re Southard & Co. Ltd.* [1979] 3 All ER 556.

62. *Id.* at 565.

63. See generally Hadden, *supra* note 60.

64. *Id.* at 65 (“[T]he creation of separate companies for particular operations, supplemented by the techniques of integrated financing, may be used to avoid liability to external creditors by relying on the limited liability of each constituent company within the group.”). See also *Cambridge Gas Transport Corp. v. Official Committee of Unsecured Creditors of Navigator Holdings, PLC* [2006] 3 All ER 829, 831 (“The business was, as is frequently the case, held through offshore companies incorporated in various jurisdictions. The ships, registered in Liberia, were owned and managed by a group of Isle of Man companies, each ship owned by a separate subsidiary of a management company and all the shares in the management company held by a holding company, Navigator Holdings plc. . . . Navigator was in turn held through a web of companies incorporated in other offshore jurisdictions.”).

presents opportunities for manipulating the corporate form [and] evading regulations and responsibilities.”<sup>65</sup> The double layer of protection from liability provides a strong motive for self-interested parties to hide behind the veil of incorporation.

This type of strategic entity construction has itself resulted in inefficiencies.<sup>66</sup> Transaction cost economics refers to this type of self-interested behavior “not as frailty of motive but as opportunism.”<sup>67</sup> In economic terms, as Yarbrough and Yarbrough note, “[t]he problems of detection and enforcement make opportunism a real threat to cooperation.”<sup>68</sup> The inability to detect and enforce rules against managers and shareholders leaves a situation ripe for opportunistic behavior as a transaction cost of group structures.<sup>69</sup> At present, the only response to this issue by global institutions such as UNCITRAL, the American Law Institute (ALI), and the International Insolvency Institute (III) is to increase communication and cooperation among and between courts and practitioners.<sup>70</sup>

### C. *Need for Change*

As discussed, the separate legal entity doctrine has been rigidly enforced by courts. Lord Sumner in *Gas Lighting Improvement Co. Ltd. v. Commissioners of Inland Revenue* referred to any allegation that duly formed companies are merely a means of effecting the shareholders’ purposes as a “layman’s fallacy.”<sup>71</sup> It is “a figure of speech, which cannot alter the legal aspect of the facts.”<sup>72</sup> This strict adherence to the letter of the law in relation to separate legal

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65. Mevorach, *Is the Future Bright*, *supra* note 29, at 370.

66. See Blumberg, *Limited Liability*, *supra* note 10, at 616–23.

67. Oliver E. Williamson, *Transaction Cost Economics: How it Works; Where it is Headed*, 146 DE ECONOMIST 23, 31 (1998).

68. Beth V. Yarbrough & Robert M. Yarbrough, *Cooperation in the Liberalization of International Trade: After Hegemony, What?*, 41 INT’L ORG. 1, 9 (1987).

69. See MEVORACH, *INSOLVENCY*, *supra* note 8, at 44–46.

70. JAY LAWRENCE WESTBROOK, *COORDINATION OF MULTINATIONAL CORPORATE GROUP INSOLVENCIES: SOLVING THE COMI ISSUE* 11 (2010), <http://iiiglobal.org/component/jdownloads/finish/362/4114.html> (“Pending further development of methods . . . a high level of communication among courts and professionals, beginning at the very start of a case, is essential to effective administration. While that is especially true in a reorganization effort, it is importantly true in liquidation as well.”).

71. *Gas Lighting Improvement Co. Ltd. v. Comm’r of Inland Revenue* [1923] AC 723, 741 (PC).

72. *Id.* at 740–41 (cited with approval by the High Court in *Hobart Bridge Co. Ltd. v. Fed. Comm’r of Taxation* (1951) 82 CLR 372, 385 (Austl.) and by Young J in *Pioneer Concrete Servs Ltd. v. Yelnah Pty Ltd.* (1986) 5 NSWLR 254 (Austl.), who warned that courts should not be involved in “the layman’s fallacy of confusing the personalities of members of a corporate group.”).

entity doctrine is almost sacrosanct. However, there is a growing concern about the problems triggered by corporate group failures.<sup>73</sup> In *Qintex Australia Finance Ltd. v. Schroders Australia Ltd.*,<sup>74</sup> Rogers J referred to the difficulties faced by liquidators and creditors in trying to reconcile the “distinction between law and commercial practice” in a *crie de cour*<sup>75</sup> for judicial intervention on the matter:

It may be desirable for parliament to consider whether this distinction between the law and commercial practice should be maintained. This is especially the case today when the many collapses of conglomerates occasion many disputes. . . . The result has been unproductive expenditure on legal costs, a reduction in the amount available to creditors, a windfall for some, and an unfair loss to others. Fairness or equity seems to have little role to play.<sup>76</sup>

As has been shown, there is a strong normative and economic justification for separate legal entity doctrine. There must be a stronger justification for altering the current status of the law. There have been some legislative responses to group problems in insolvency, at least, within the jurisdictional confines of Australia under the Corporations Act.<sup>77</sup> The justification for these changes is often tied to a showing of wrongdoing on the part of those running the corporations.<sup>78</sup> For example, in *Dennis Willcox Pty Ltd. v. Federal Commissioner of Taxation*,<sup>79</sup> Jenkinson J, with whom Woodward and Foster JJ of the Federal Court agreed, summarised Young J's reasoning in *Pioneer Concrete Services Ltd. v. Yelnah Pty Ltd.* on why a court might lift the corporate veil:

[T]he separate legal personality of a company is to be disregarded only if the court can see that there is in fact or in law a partnership between companies in a group, or that there is a mere sham or facade in which that company is playing a role, or that the creation or use of the company was designed to enable a legal or fiduciary obligation to be evaded or fraud to be perpetrated.<sup>80</sup>

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73. See generally Blumberg, *Transformation*, *supra* note 41 (discussing issues associated with corporate group failures).

74. *Qintex Austl Fin Lt. v. Schroders Austl Ltd.* (1990) 3 ACSR 267, 269 (Austl.).

75. Usually an appeal for judicial intervention to remedy a problem that is beyond the powers of the court to remedy.

76. *Qintex* (1990) 3 ACSR at 269 (Austl.).

77. *Corporations Act 2001* (Cth) (Austl.).

78. Helen Anderson, *Piercing the Veil on Corporate Groups in Australia: The Case for Reform*, 33 MELB. U. L. REV. 333, 354 (2009).

79. *Dennis Willcox Pty Ltd. v. Fed. Comm'r of Taxation* (1988) 79 ALR 267 (Austl.).

80. *Id.* at 272.

An examination of the ‘problems’ of corporate groups reveals that courts and legislators have been prepared to chip away at the inviolability of the limited liability of corporations in certain narrow circumstances but not uniformly.

The majority of corporations in Australia are small to medium-sized enterprises whose directors and managers are not necessarily legally sophisticated or organized.<sup>81</sup> The delineation of obligations and liabilities between group members in these small, tightly integrated groups is often blurred.<sup>82</sup> This presents few difficulties for solvent companies; however once a member of the group becomes insolvent, a liquidator must understand and redress what is often a disarray of undocumented interactions between companies in the group.<sup>83</sup>

The problem is often stated as the distinction between the separate entity status that is so sacrosanct in law and what is referred to as ‘commercial’ or ‘economic’ reality.<sup>84</sup> Groups as a whole sometimes operate as a single business.<sup>85</sup> While the separate entity doctrine is enforced in dealings with those outside the corporate group, within the group there is often a melange of inter-company dealings that ignore the separate entities that comprise the group.<sup>86</sup> In Australia, the common law and the Corporations Act 2001 contain several instances—outlined below—where separate entity status is departed from.<sup>87</sup> As will be shown in Part II below, these types of instances seldom occur and are of limited effect in practice,<sup>88</sup> but they are an important indicator of progress towards a global solution.

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81. See ELLIS CONNOLLY, DAVID NORMAN & TIM WEST, *SMALL BUSINESS: AN ECONOMIC OVERVIEW 3* (2012), <http://www.rba.gov.au/publications/workshops/other/small-bus-fin-roundtable-2012/pdf/01-overview.pdf> (stating that “[a]round 95 per cent of the 2 million actively trading businesses in Australia in 2011 were small businesses: around two thirds had no employees, a quarter had up to four employees and a tenth had between 5 and 19 employees.”).

82. See e.g., *Walker v. Wimborne* (1976) 137 CLR 1, 4–6 (Austl.).

83. See *id.*

84. See Michael J. Gaertner, *Reverse Piercing the Corporate Veil: Should Corporation Owners Have It Both Ways*, 30 WM. & MARY L. REV. 667, 676–77 (1989).

85. Mevorach, *Is the Future Bright*, *supra* note 29, at 370.

86. See *Walker v. Wimborne* (1976) 137 CLR 1 (Austl.).

87. See *infra* Part III.

88. Jenny Dickfos, et al., *The Insolvency Implications for Corporate Groups in Australia – Recent Events and Initiatives*, 16 INT. INSOLV. REV. 103 (2007).

## II. RESPONSES TO CORPORATE GROUP INSOLVENCY IN AUSTRALIA

This Section details Australia's response to the challenge of group insolvency. At a national level, the legal response to group insolvency has been unsystematic. The law has responded reactively to address problems facing creditors, practitioners, and courts.<sup>89</sup> Failure to adopt a cohesive and comprehensive law also causes lack of certainty for all participants.<sup>90</sup> The application of the common law veil piercing doctrine, for example, creates immense uncertainty for creditors dealing with corporate groups, as creditors are unable to predict with certainty when a court might pierce the veil.<sup>91</sup> This Section shows that courts have exercised the piercing option only in limited circumstances.

Since the publication of the Harmer Report in 1988,<sup>92</sup> there have been efforts to introduce statutory remedies for creditors of corporate groups.<sup>93</sup> However, the Corporations Act 2001 was only recently amended to make parent companies liable for the debts of subsidiaries in certain circumstances and for group assets to be pooled to pay creditors of one subsidiary.<sup>94</sup> The circumstances in which these provisions apply are tightly delimited within this legislation, and the provisions are used sparingly.

### A. *Definition of Group*

Van der Laan and Dean have noted that what characterized a corporate group under Australian common law was "a set of corporations with common ownership or control."<sup>95</sup> In *Walker v. Wimborne*,<sup>96</sup> the relevant group of companies was administered as a group but did not have common or interlocking shareholding and the degree of financial interdependence was not high. The High Court in *Walker* held that "the word 'group' is generally applied to a number of companies which are associated by common or inter-

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89. *Infra* Part III.D. At least since 1988, there have been calls to amend the Corporations legislation to address these issues. See generally HARMER REPORT, *supra* note 26 (report commissioned by Australian government discussing corporations law reform).

90. MEVORACH, *INSOLVENCY*, *supra* note 8, at 270.

91. See Anderson, *supra* note 78, at 359.

92. HARMER REPORT, *supra* note 26, at 139.

93. See, e.g., CASAC Report, *supra* note 26.

94. Section 588V was introduced shortly after the Harmer Report recommended its introduction but the Corporations Act 2001 was only amended in 2007 to provide for pooling determinations and pooling orders. *Corporations Amendment (Insolvency) Act 2007* (Cth) div 8 (Austl.).

95. van der Laan & Dean, *supra* note 52, at 122–23.

96. *Walker v. Wimborne* (1976) 137 CLR 1, 6 (Austl.).

locking shareholdings.”<sup>97</sup> This test is used today in cases seeking to pierce the corporate veil.

Corporate groups are not defined by the Corporations Act 2001. However, sections of the Act do address pooling group assets in liquidation, and these provisions do not rely on a common law definition but rather its plain or ordinary meaning of a “collection or plurality.”<sup>98</sup> Section 579E of the Act deals with the pooling of assets of corporate group insolvencies.<sup>99</sup> Justice Barrett in *Allen v. Feather Products Pty Ltd.*,<sup>100</sup> referring to the use of the word “group” in 579E stated that:

Section 579E(1) directs attention to ‘a group of 2 or more companies.’ The expression ‘group’ is not defined. It should therefore be given its ordinary meaning of a collection or plurality. A ‘group’ will exist for these purposes simply if two or more companies are identified. The ‘group’ terminology does not require anything more. The need for the identified companies to have certain attributes of connectedness comes from aspects of s 579E other than the word ‘group.’<sup>101</sup>

Section 579E applies if all companies in a group are ‘wound up.’<sup>102</sup> The characterization of groups in 579E is broader than the common law definition of companies “associated by common or

97. *Id.*

98. See *Allen v. Feather Prods. Pty Ltd.* [2008] 216 FLR 263, 265 (Austl.) (stating that under the Corporations Act, members of a group must be linked in a way outlined in Section 579E(1)(b)(i)–(iv)).

99. Corporations Act 2001 Section 579E provides:

(1) If it appears to the Court that the following conditions are satisfied in relation to a group of 2 or more companies:

(a) each company in the group is being wound up;

(b) any of the following subparagraphs applies:

(i) each company in the group is a related body corporate of each other company in the group;

(ii) apart from this section, the companies in the group are jointly liable for one or more debts or claims;

(iii) the companies in the group jointly own or operate particular property that is or was used, or for use, in connection with a business, a scheme, or an undertaking, carried on jointly by the companies in the group;

(iv) one or more companies in the group own particular property that is or was used, or for use, by any or all of the companies in the group in connection with a business, a scheme, or an undertaking, carried on jointly by the companies in the group;

the Court may, if the Court is satisfied that it is just and equitable to do so, by order, determine that the group is a pooled group for the purposes of this section. *Corporations Act 2001* (Cth) s 579E (Austl.).

100. *Allen v. Feather Prods. Pty Ltd.* [2008] 216 FLR 263 (Austl.).

101. *Id.* at 265. This approach was affirmed by Barrett J in *Re Kirby Street (Holding) Pty Ltd.* [2011] NSWSC 1536 ¶ 8 (Austl.).

102. Winding up is the term used in Australian corporate law to refer to the process of liquidating the assets of a corporation, making distributions to creditors and dissolving the company.

interlocking shareholdings, allied to unified control or capacity to control.”<sup>103</sup> Under the Corporations Act, members of a group must be linked in a way outlined in Section 579E(1)(b)(i)–(iv).<sup>104</sup> Under that subsection, companies are sufficiently linked as groups if they are related corporate bodies,<sup>105</sup> if they are jointly liable for a debt or claim, if they jointly own or operate property used in a business carried on by the companies, or if one of the companies owns property that is used by any of the companies for a business carried on jointly by the companies in the group.<sup>106</sup> Theoretically, this broader definition should allow a more liberal approach to the governance of groups by courts. However, it remains to be seen if this theory will be borne out in practice.

### B. Common Law – Piercing the Corporate Veil

The definition of groups differs slightly between the common law and statute and depends on what type of relief is sought. The following parts outline the common law response of lifting the corporate veil and the limited statutory responses available in Australia, including contribution orders, holding the holding company liable for the debts of the subsidiary, and pooling of group assets to pay the debts of one or other group member.

The protection afforded to corporations in the form of separate legal personality is often referred to as a veil of incorporation.<sup>107</sup> In certain circumstances, courts have been prepared to ignore the separate legal entity doctrine and pierce or lift the corporate veil. The distinction was referred to in *Atlas Maritime Co. S.A. v. Avalon Maritime Ltd. (No. 1)*<sup>108</sup> by Staughton LJ.<sup>109</sup>

In the years since this terminology was first invoked, the veil has become less translucent and now conceals the true face of the corporate group.<sup>110</sup> Merely lifting the corporate veil may sound easy

103. *Walker v. Wimborne* (1976) 137 CLR 1, 6 (Austl.).

104. *Corporations Act 2001* (Cth) s 579E(1)(b)(i)–(iv) (Austl.).

105. Under § 50 of the Corporations Act, a holding company and its subsidiary or two subsidiaries of the same holding company are related bodies corporate. *Id.* s 50.

106. *Id.* s 579E(1)(b)(ii)–(iv).

107. See Easterbrook & Fischel, *supra* note 44, at 109–11.

108. [1991] All E.R. 769 (CA).

109. *Id.* at 779. (“Like all metaphors, this phrase can sometimes obscure reasoning rather than elucidate it. There are, I think, two senses in which it is used, which need to be distinguished. To *pierce* the corporate veil is an expression that I would reserve for treating the rights or liabilities or activities of the company as the rights or liabilities or activities of its shareholders. To *lift* the corporate veil or *look behind* it, on the other hand, should mean to have regard to the shareholding in the company for some legal purpose.”).

110. See Blumberg, *Transformation*, *supra* note 41, at 611–12; Anderson, *supra* note 7.

and less obtrusive, but in reality, piercing or completely removing the corporate mask is often required.<sup>111</sup> However, the law continues to use this somewhat quaint terminology, which conveys innocence rather than malevolence. Piercing the corporate veil is only used as an *exception* to the separate legal entity law in Australia in rare cases.<sup>112</sup>

The circumstances under which a court might be willing to pierce the veil remain unpredictable to those operating in the commercial world. This fact was admitted by Rogers AJA in *Briggs v. James Hardie & Co. Pty Ltd.*,<sup>113</sup> who stated that “[t]he threshold problem arises from the fact there is no common, unifying principle, which underlies the occasional decision of the courts to pierce the corporate veil.”<sup>114</sup> Conscious of the dichotomy between legal principle and actual practice in the business world with group companies, the judge said that “[t]he law pays scant regard to the commercial reality that every holding company has the potential and, more often than not, in fact, does, exercise complete control over a subsidiary.”<sup>115</sup>

Furthermore, *Commissioner of Taxation v. BHP Billiton Finance Ltd.* (BHP)<sup>116</sup> exemplifies the difficulty of using a law designed before the modern sophisticated commercial context. In *BHP*, the Commissioner argued that one of the BHP group of companies acted as a “mere conduit” of its parent.<sup>117</sup> The court rejected that assertion in this case. Hargovan and Harris refer to the Commissioner’s failed argument to try to pierce the corporate veil as “fanciful”<sup>118</sup>

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111. See generally Jason Harris & Anil Hargovan, *Cutting the Gordian Knot of Corporate Law: Revisiting Veil Piercing in Corporate Groups*, 26 AUSTL. J. CORP. L. 39 (2011) (arguing that confusion surrounding corporate veil piercing is based on misconceptions about the law of agency).

112. See Helen Anderson, *Challenging the Limited Liability of Parent Companies: A Reform Agenda for Piercing the Corporate Veil*, 22 AUSTL. ACCT. REV. 129, 133 (2012) (“veil piercing in Australia is limited to quite extreme circumstances.”). See also Anderson, *supra* note 7, at 354; Easterbrook & Fischel, *supra* note 44, at 89 (“Piercing seems to happen freakishly. Like lightning, it is rare, severe, and unprincipled.”).

113. *Briggs v. James Hardie & Co. Pty Ltd.* (1989) 16 NSWLR 549 (Austl.).

114. *Id.* at 567–68. (“The rule in *Salomon* was laid down at a time when economic circumstances were vastly different. The principle of *laissez faire* ruled supreme and the fostering of business enterprise demanded that the principle of limited liability be rigidly maintained. To date, the effect of incorporation has remained the same, notwithstanding the proliferation of conglomerates, holding companies and subsidiaries.”).

115. *Id.* at 577.

116. *Comm’r of Taxation v. BHP Billiton Fin. Ltd.* (2010) 182 FCR 526 (Austl.); [2010] FCAFC 25 (Austl.).

117. (2010) 182 FCR 526 ¶ 14 (Austl.).

118. Anil Hargovan & Jason Harris, *Together Alone: Corporate Group Structures and Their Legal Status Revisited*, 39 AUSTL. BUS. L. REV. 85, 93 (2011).

and say that “[t]o argue that a subsidiary is a mere conduit because its strategy is set by the parent, its employees are hired by the parent and its decisions ultimately come under the supervision of the parent is to ignore the result in the *Salomon* case.”<sup>119</sup> They also claim that “Australian corporate law is reasonably settled . . . that parent and subsidiary company relationships commonly involve extensive (even overwhelming) control being exercised by the parent, however this is not sufficient to pierce the corporate veil.”<sup>120</sup>

However, the decision in *BHP* shows that a law that allows a corporate enterprise with over 460 controlled entities to benefit from taxation and to limit the liability of the parent corporation and its directors and shareholders, is out of touch with commercial realities.<sup>121</sup>

Anderson notes that “veil piercing in Australia is limited to quite extreme circumstances”<sup>122</sup> but argues that the “notion of fault—under-capitalization of a subsidiary, inadequate insurance, and value reducing behavior through intra-group contractual arrangements [should be] the basis for piercing the corporate veil on parent companies in corporate groups.”<sup>123</sup> As the jurisprudence develops alongside the legislative changes detailed below, perhaps the circumstances outlined by Anderson will provide a more structured and principled approach, hinted at by Rogers AJA.<sup>124</sup>

### C. *Legislative Responses*

Mere control or dominance by one group member or a parent over another is not a sufficient reason to ignore the separate legal entity status of corporations within a group. However, the law may ignore the separation when there is sufficient control or ownership of one company over another and other factors combine.<sup>125</sup> The UNCITRAL *Legislative Guide*<sup>126</sup> sets out a number of circumstances in laws around the world where liability might be extended to other (even solvent) group members; it also includes situations

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119. *Id.*

120. *Id.*

121. Anderson, *supra* note 78, at 359 (Anderson “makes the case for legislation to be enacted to pierce the corporate veil on corporate groups” to reduce uncertainty, provide clarity and to provide a “clear signal” that it is appropriate to pierce the veil).

122. Anderson, *supra* note 112, at 133.

123. *Id.* at 132.

124. See *Qintex Austl Fin. Ltd. v. Schroders Austl Ltd.* (1990) 3 ACSR 267, 269 (Austl.).

125. See Anderson, *supra* note 78, at 354.

126. U.N. COMM’N ON INT’L TRADE LAW, UNCITRAL LEGISLATIVE GUIDE ON INSOLVENCY LAW: PART THREE: TREATMENT OF ENTERPRISE GROUPS IN INSOLVENCY, at 56–57, U.N. Sales No. E.12.V.16 (2012) [hereinafter LEGISLATIVE GUIDE ON INSOLVENCY LAW: PART THREE].

involving deliberate or fraudulent conduct designed to exploit or cause injury to those involved with the group.<sup>127</sup>

On a national level, Australia has recently developed some, albeit limited, responses to the reality of modern corporate enterprises. Comments such as those by Rogers AJA in *Briggs v. James Hardie*<sup>128</sup> and *Qintex Australia*<sup>129</sup> contributed to the amendment of the Corporations Act, and insertion of Section 588V, which made holding companies liable for the subsidiary's insolvent trading—if the holding company was aware or should have been aware that the subsidiary was trading while insolvent.<sup>130</sup> Section 588W provides a mechanism for recovery by a creditor from the company in the same circumstances when he or she has suffered loss or damage in relation to the debt because of the insolvency.<sup>131</sup> These changes recognize the reality of group structures and overrule the separate legal entity doctrine in appropriate circumstances.

#### D. *Contribution to the Debts of a Subsidiary*

The 1988 Harmer Report recommended that the Australian government enact a general contribution power to require holding companies to meet the debts of their subsidiary if the court was “satisfied that it was just.”<sup>132</sup> The Harmer Report recommended that in making their decisions, courts would consider “the extent to which the related company took part in the management of the

127. *Id.*

128. See generally *Briggs v. James Hardie & Co. Pty Ltd.* (1989) 16 NSWLR 549 (Austl.) (explaining that there is no principles approach for courts to pierce the corporate veil).

129. See generally *Qintex Austl Fin. Ltd. V. Schroders Austl Ltd.*, (1990) 3 ACSR 267, 269 (discussing the role of parliament in developing law).

130. Section 588V provides that a holding company is in breach of the section, if it, or one or more of its directors, is or are aware or suspects that the subsidiary is insolvent, or given the nature and extent of control over the other company's affairs it would be reasonable to suspect that the subsidiary was insolvent. *Corporations Act 2001* (Cth) s 588V (Austl.).

131. Section 588W: Recovery of compensation for loss resulting from insolvent trading, states:

(1) Where:

(a) a corporation has contravened section 588V in relation to the incurring of a debt by a company; and  
 (b) the person to whom the debt is owed has suffered loss or damage in relation to the debt because of the company's insolvency; and  
 (c) the debt was wholly or partly unsecured when the loss or damage was suffered; and  
 (d) the company is being wound up;

the company's liquidator may recover from the corporation, as a debt due to the company, an amount equal to the amount of the loss or damage. *Corporations Act 2001* (Cth) s 588V (Austl.).

132. HARMER REPORT, *supra* note 26, at 146.

company; the conduct of the related company towards the creditors of the company; and the extent to which the circumstances that gave rise to the winding up of the company are attributable to the actions of the related company.”<sup>133</sup>

This recommendation was opposed by the Law Council of Australia for eroding the separate entity principle, restricting project financing needed on a “limited recourse basis,” and creating “uncertainty in commercial dealings.”<sup>134</sup> Instead of enacting a general contribution power, in 1992, the government introduced legislation under which a holding company would be liable for the debts of the subsidiary *only if* it had traded while insolvent and the holding company was aware that there were reasonable grounds for suspecting that it was insolvent.<sup>135</sup>

In 2000, the Australian Companies & Securities Advisory Committee (CASAC) *Corporate Groups Final Report* stopped short of recommending that courts be granted general power to order a holding company to pay the debts of its subsidiary.<sup>136</sup> However the CASAC Report did recommend that “[c]ourts should be permitted to make pooling orders in the liquidation of two or more companies.”<sup>137</sup> After the CASAC Report, the government further amended the Corporations Act to include pooling remedies, discussed below.<sup>138</sup>

The current law does not extend liability to other solvent corporate group members to meet the liabilities of the insolvent member.<sup>139</sup> Under the Australian Corporations Act, where the threshold to a pooling order is that each company in the group must be being wound up.<sup>140</sup>

### E. *Pooling*

Voluntary pooling is a mechanism that has been available under Part 5.1 of the Australian Corporations Act for schemes of arrange-

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133. *Id.* at 146.

134. *Id.* at 147. It is interesting to note that these criteria are now set out in s 579E(12) as criteria to which the courts must have regard in making a pooling order.

135. *Corporations Act 2001* (Cth) s 588V (Austl.).

136. CASAC Report, *supra* note 26, at 165.

137. *Id.* at iii.

138. The Corporations Act 2001 was amended by Corporations Amendment (Insolvency) Act 2007 to provide for pooling determinations and pooling orders.

139. Under the Corporations Act 2001 Section 579E(1)(a) the court may only make a pooling order if “each company in the group is being wound up.” Similarly, under Section 571(1)(a), a liquidator may only make a pooling determination “if each company in the group is being wound up.”

140. *Corporations Act 2001* (Cth) s 579E(1)(a) (Austl.).

ment,<sup>141</sup> under Part 5.5 for voluntary winding up,<sup>142</sup> and under the general powers of a liquidator under Section 477 to make a compromise with creditors.<sup>143</sup> In 2000, CASAC recommended allowing liquidators to “pool the unsecured assets, and the liabilities, of two or more group companies in liquidation with the prior approval of all unsecured creditors of those companies.”<sup>144</sup> The Corporations Act now allows a liquidator to make a pooling determination.<sup>145</sup> Section 578 is the relevant provision with regard to the effectuation of the pooling determination.<sup>146</sup>

There are several consequences that follow upon the making of a pooling determination under Section 571(2):

- (a) each company in the group is taken to be jointly and severally liable for each debt payable by, and each claim against, each other company in the group; and
- (b) each debt payable by a company or companies in the group to any other company or companies in the group is extinguished; and
- (c) each claim that a company or companies in the group has against any other company or companies in the group is extinguished.<sup>147</sup>

Crucially, the powers of the liquidator under Section 477 are not limited by Section 571.<sup>148</sup> It is also worth noting that the pooling determination is not absolute and final.<sup>149</sup> A court has the power to terminate or modify it in certain circumstances as stipulated by

141. *See id.* pt 5.1. (A scheme of arrangement includes a shareholder agreement to reorganize a company’s share structure, assets or liabilities and is often used to effect a 100% acquisition of shares in a target company. This can be by way of transfer or cancellation of shares in exchange for the consideration proposed under the scheme. The scheme is approved by the court and is binding on all shareholders.)

142. *See id.* s 510.

143. *See generally* Mary Wyburn, *Pooling as a Response to the Competing Interests in Corporate Group Collapse in Australia*, 19 INT’L INSOLVENCY REV. 65, 76–79 (2010) (powers of a liquidator may be used for voluntary pooling).

144. CASAC Report, *supra* note 26, at 176 (recommendation 22).

145. *See Corporations Act 2001* (Cth) ss 571, 577–78 (Austl.).

146. Corporations Act Section 578 provides that after a pooling determination has been made in respect of two or more companies and:

- (b) meetings are convened under section 574 of the eligible unsecured creditors of each company in the group; and
- (c) at each meeting, the eligible unsecured creditors pass a resolution, in accordance with section 577, approving the making of the determination; then:
  - (d) if all the resolutions were passed at the same time – the determination comes into force immediately after the resolutions were passed; or
  - (e) if the resolutions were passed at different times – the determination comes into force immediately after the last of those times. *Id.* s 578.

147. *Id.* s 571(2).

148. *Id.* s 571(11).

149. The court may vary a pooling determination under Section 572.

Section 579A for example, if it was satisfied that the liquidator or unsecured creditors were given false or misleading information about the business, property, or affairs of a company in the group, or the pooling determination would cause injustice or delay or would be oppressive or unfairly prejudicial to, or unfairly discriminatory against, an applicant for the order who is an eligible unsecured creditor of a company in the group.<sup>150</sup>

The court may make a pooling order upon an application by the liquidator of companies in the group if it is just and equitable to do so under Section 579E(12).<sup>151</sup> The statute provides guidance to the court in determining when such is just and equitable. The factors to be considered are: (1) the extent to which a company in the group and the officers and employees of a company in the group were involved in the management of the affairs of another company;<sup>152</sup> (2) the involvement of a company in the group and officers and employees toward creditors of other companies in the group;<sup>153</sup> (3) the extent to which the circumstances that gave rise to the winding up of any of the companies in the group are directly or indirectly attributable to the acts or omissions of officers or employees or a company in the group;<sup>154</sup> (4) the degree of intermingling of the activities and operations of the companies in the group;<sup>155</sup> (5) the consequences of making the order on creditors;<sup>156</sup> and (6) any other relevant factors.<sup>157</sup>

The court has the power to make ancillary orders it deems just and equitable upon the making of a pooling order.<sup>158</sup> These

150. *Corporations Act 2001* (Cth) s 579A(1) (Austl.). Clause (2) stipulates who may approach the court for such an order:

- (a) a creditor of a company in the group; or
- (b) in a case where a company in the group is being wound up under a members' voluntary winding up – a member of the company, so long as the member is not a company in the group; or
- (c) any other interested person.

*Id.* s 579A(2).

151. *Id.* s 579E(12).

152. *Id.* s 579E(12)(a).

153. *Id.* s 579E(12)(b).

154. *Id.* s 579E(12)(c).

155. *Id.* s 579E(12)(d).

156. *Id.* s 579E(12)(e).

157. *Id.* s 579E(12)(f).

158. *Id.* s 579G. Clause 2 provides that 'An order or direction under subsection (1) may only be made or given on the application of:

- (a) the liquidator of a company in the group; or
- (b) a creditor of a company in the group; or
- (c) in a case where a company in the group is being wound up under a members' voluntary winding up – a member of the company, so long as the member is not a company in the group.

orders can exempt certain debts, transfer property, or transfer liability for debts from a company to another company in the group.<sup>159</sup> Conditions can also be imposed upon the making of such orders.<sup>160</sup>

There are several consequences that follow from the making of a pooling order: (1) each company in the group becomes jointly and severally liable for each debt payable by, and each claim against, each other company in the group; (2) debts payable by a company to other intra-group companies are extinguished; and (3) claims held by a company against other intra-group companies are extinguished.<sup>161</sup> Crucially, the pooling order does not alter the order of priority of payment to specified unsecured creditors under Section 556, and particularly to employees under Sections 560 and 561.<sup>162</sup>

Wyburn notes that the practical outcome of a pooling determination or a pooling order is that “a single bank account [is] used, consolidated meetings of creditors [are] held, intra-group debt will be extinguished and distribution to creditors will occur in accordance with the Corporations Act priorities, except that group companies will be treated as if there was a single company in liquidation.”<sup>163</sup> The statute further stipulates that the court must not make a pooling order if an eligible unsecured creditor would be disadvantaged or has not consented to the order—or even if a shareholder of a company in the group (that is not itself another company in the group) has not consented to and would be materially disadvantaged by the order.<sup>164</sup>

In the seven years since these sections were enacted, there have only been a handful of cases successfully invoking them. In *Kirby Street (Holding) Pty Ltd., Re Lombe*,<sup>165</sup> Barrett J allowed a pooling order under 579E in relation to 40 companies opining that “clear advantages . . . will flow from bringing these administrations to a conclusion on a consolidated basis.”<sup>166</sup> *Kirby* summarized the test under Section 579E as follows:

(1) Is there “a group of 2 or more companies” (s 579E(1), introductory words)?

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159. *Id.* s 579G(1)(b) and (c).

160. *Id.* s 579G(3).

161. *Id.* s 579E(2).

162. *Id.* s 579E(5).

163. Wyburn, *supra* note 143, at 97.

164. *Corporations Act 2001* (Cth) s 579E(10) (Austl.).

165. *Kirby Street (Holding) Pty Ltd., Re Lombe* [2011] NSWSC 1536 (Austl.).

166. *Id.* ¶ 94; see also *Lofthouse v. Envtl. Consultants Int'l* [2012] VSC 416 (Austl.) (granting a pooling order).

- (2) Is each company in the group being wound up (s 579E(1)(a))?
- (3) Is at least one of the conditions in subparas (i)–(iv) of s 579E(1)(b) satisfied?
- (4) What does the evidence show with respect to the matters in s 579E(12) as they may affect the answer to the following question 5?
- (5) Is it just and equitable that the order sought be made (s 579E(1)(b) concluding words)?
- (6) Does s 579E(10) preclude the making of a pooling order?<sup>167</sup>

A more recent example is *Re ZYX Learning Centres Limited (Formerly ABC Learning Centres Limited) (Receivers and Managers Appointed) (in liq)*.<sup>168</sup> In this case, ZYX was the parent of ZYX Developmental Learning Centres Pty Ltd. (DLC). Liquidators sought a pooling order for the two companies so that they would “be able to meet the priority claims of employees, [as] the employees of ZYX Group were employed by DLC . . . [but] the bulk of unsecured creditors, both in quantum and number, [we]re creditors or contingent creditors of the parent company of DLC, being ZYX.”<sup>169</sup> Facts relevant to issuing a pooling order included that no creditors of either company appeared in the proceedings to contradict the orders, that the receivers appointed to manage the companies had been operating them for the previous six years on a pooled basis and that it would be “difficult, [time consuming] and expensive” to now apportion settlement sums on an entity basis.<sup>170</sup>

Justice Jagot compared the position of creditors if a pooling order was made against their position if it was not. She stated that:

If the pooling order is made, the priority creditors of DLC—in effect, the employees—will receive a return of 100 cents in the dollar. However, if the pooling order is not made, those priority creditors [the employees] will receive a dividend of 19 cents in the dollar. Further, if the pooling order is made, the unsecured creditors of ZYX will receive no return. If the pooling order is [not] made, those unsecured creditors may receive a return of 0.23 cents in the dollar.<sup>171</sup>

She also considered issues as required under s 579E(12) including the test set out in *Re Lombe*, and subsequently issued the pooling order.

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167. [2011] NSWSC 1536 ¶ 7 (Austl.).

168. *Re ZYX Learning Centres Ltd.* [2015] FCA 146 (Austl.) (Jagot J.).

169. *Id.* ¶ 13.

170. *Id.* ¶ 16.

171. *Id.* ¶ 26.

The limited common law and legislative responses detailed herein have little impact and are rarely invoked successfully in group situations. Ramsay and Noakes conducted a study that included all cases in Australia until 2000 where an argument was made to ‘pierce the corporate veil.’ They found that, of the 104 cases studied, courts pierced the veil in approximately 39 percent of cases; courts pierced the corporate veil more frequently in cases involving proprietary companies (42 percent) than for public companies (22 percent); the piercing rate for companies with only one shareholder was around 45 percent and decreased as the number of shareholders increased; and “piercing rates are highest when the ground advanced for piercing the corporate veil is one of unfairness/interests of justice. All other grounds advanced for piercing the veil had significantly lower piercing rates with the *lowest being the group enterprises argument*.”<sup>172</sup> Consequently, the arguments about the negative effects of corporate groups, such as those put forward by Hadden,<sup>173</sup> remain weak arguments for disregarding the separate legal entity doctrine, at least as applied to Australia.

### III. MULTINATIONAL ENTERPRISE GROUPS

Despite the predominance of the corporate group structure in international business, no international law exists to govern the insolvency of corporate groups with a cross-border element.<sup>174</sup> Per Mevorach, this is not the result of a failure to appreciate the importance of the issue, but a result of the “complexity of the matter.”<sup>175</sup> Cross-border insolvencies now take up a significant portion of the business of both the United Nations Commission on International Trade Law’s (UNCITRAL) Working Group V<sup>176</sup> and the European Commission.<sup>177</sup>

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172. Ian M. Ramsay & David B. Noakes, *Piercing the Corporate Veil in Australia*, 19 COMPANY & SEC. L.J. 250, 267 (2001) (emphasis added).

173. See Hadden, *supra* note 60.

174. See LEGISLATIVE GUIDE ON INSOLVENCY LAW: PART THREE, *supra* note 126, at 108.

175. Mevorach, *Towards a Consensus*, *supra* note 19, at 362.

176. See U.N., Comm’n on Int’l Trade Law [UNCITRAL], Working Group V (Insolvency Law), Facilitating the Cross-Border Insolvency of Multinational Enterprise Groups, Note by the Secretariat, U.N. Doc A/CN.9/WG.V/WP.124 (Oct. 2, 2014).

177. See *Commission Proposal for a Regulation of the European Parliament and of the Council Amending Council Regulation (EC) No 1346/2000 on Insolvency Proceedings*, COM (2012) 744 final (Dec. 12, 2012).

Global initiatives generally refer not to 'corporate groups' but to 'enterprise groups' comprised of two or more enterprises.<sup>178</sup> UNCITRAL's *Legislative Guide on Insolvency Law Part Three: Treatment of Enterprise Groups in Insolvency* defines an enterprise as "any entity, regardless of its legal form, that is engaged in economic activities and may be governed by the insolvency law."<sup>179</sup> Consequently, an enterprise group is defined as "two or more corporations that are linked together by some form of control . . . or ownership."<sup>180</sup> According to the *Legislative Guide*:

[e]nterprise group structures may be simple or highly complex, involving numbers of wholly or partly owned subsidiaries, operating subsidiaries, sub-subsidiaries, sub-holding companies, service companies, dormant companies, cross-directorships, equity ownership and so forth. They may also involve other types of entity, such as special purpose entities (SPE), joint ventures, offshore trusts, income trusts and partnerships.<sup>181</sup>

Other forms of enterprise suggested include entities 'tied by contract or by equity' such as franchises or licensees' affiliates which are linked by control or coordination.<sup>182</sup> While these may constitute forms of enterprise, the definition of enterprise for the purposes of insolvency law in the *Legislative Guide* presupposes that any qualifying entity be "governed by the insolvency law."<sup>183</sup> Clearly, though, the scope must extend beyond the corporate form.

The tension arises between treating each entity as a separate legal person and treating groups as a whole enterprise in a single proceeding. That tension is not easy to relieve, as the normative

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178. See generally *Legislative Guide Part Three*, *supra* note 17; INTERNATIONAL INSOLVENCY INSTITUTE, PROSPECTIVE PRINCIPLES FOR COORDINATION OF MULTINATIONAL ENTERPRISE GROUP INSOLVENCIES (2012), <http://iiglobal.org/component/jdownloads/finish/362/5953.html> (while the corporate form is the predominant form of business structure in the world, in the international context, other types of entities operate, are susceptible to insolvency laws and must be accommodated).

179. *Legislative Guide Part Three*, *supra* note 17, at 3.

180. *Id.* at 3–4. The varying scale of ownership and control sufficient to meet the definition is explained further in the *Legislative Guide*. Working Group V notes that these groups "have been in existence for some time, emerging in some countries, according to commentators, at the end of the 19th and beginning of the 20th century through a process of internal expansion, which involved companies taking control of their own financial, technical or commercial capacities. These single entity enterprises then expanded externally to take legal or economic control of other corporations. . . . One of the factors supporting this expansion, at least in some jurisdictions, was the legitimatization of ownership of the shares of one corporation by another corporation; a phenomenon originally prohibited in both common law and civil law systems." *Id.* at 4.

181. *Id.* at 4–5.

182. See IRIT MEVORACH, INSOLVENCY WITHIN MULTINATIONAL ENTERPRISE GROUPS 22–25 (2009).

183. *Legislative Guide Part Three*, *supra* note 17, at 3.

pull of entity law is strong.<sup>184</sup> The procedural solutions available, depending on which end of that normative spectrum an enterprise sits, vary between coordinating disparate proceedings in different countries to trying to consolidate a group to be administered from a single jurisdiction.<sup>185</sup> Depending on the level of integration of the group enterprise, it may be possible to establish a central jurisdiction from which the consolidated proceedings would be run. However, if the group is less integrated and centralized, it would be difficult to agree such a centralized jurisdiction to the satisfaction of all participants.

### A. *Entity Versus Enterprise Law*

Blumberg distinguishes between *entity* law, which emphasizes the individual treatment of separate legal entities, and *enterprise* law, which forms the basis of a line of analysis of multinational enterprise groups in insolvency.<sup>186</sup> Blumberg argues that “[t]he reality . . . which the law must take into account, is that large multinational corporations with hundreds of thousands of public shareholders and corporate structures of ‘incredible complexity’ dominate the modern business world.”<sup>187</sup> Westbrook also refers to the problems associated with treating enterprise groups as a whole rather than as distinct legal entities as “the central difficulty” in group insolvencies.<sup>188</sup>

Blumberg argues that enterprise law in judicial and statutory treatment of corporate groups is determined in large part by reference to the amount of control exerted by one entity within the group over others, and the economic intertwining of activity between members.<sup>189</sup> However, this alone is not enough to confirm that a group is acting as an enterprise. He notes four additional factors: first, a common public persona (shared name, logo, marketing plan); second, financial interdependence where the subsidiaries do not raise their own capital independently; third, administrative interdependence where the subsidiary uses the parent’s legal, auditing, tax, public relations, safety, engineering, or

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184. Mevorach, *Towards a Consensus*, *supra* note 19, at 374–75.

185. See *id.* at 376–78.

186. See, e.g., Blumberg, *The Corporate Entity*, *supra* note 29; Blumberg, *Limited Liability*, *supra* note 10; Mevorach, *Towards a Consensus*, *supra* note 19; Mevorach, *Is the Future Bright*, *supra* note 29; and Legislative Guide Part Three, *supra* note 17, at 16–18.

187. Blumberg, *The Corporate Entity*, *supra* note 29, at 287.

188. WESTBROOK, *supra* note 70, at 9.

189. See Blumberg, *The Corporate Entity*, *supra* note 29, at 329–30.

research and development departments; fourth, group-wide stock option, retirement, medical insurance and benefit plans.<sup>190</sup>

Hence the economic reality and not the legal form of the corporate group should determine whether the group is to be treated as an enterprise. These general problems with corporate groups are being addressed, albeit slowly, by “judicial development of enterprise law,” including in bankruptcy law, “to achieve equality and fairness in the distribution of a debtor’s assets to creditors.”<sup>191</sup> Still, while academics like Blumberg and Mevorach recognize the benefits of adopting aspects of enterprise law, there is still little prospect of a global harmonized law in the area.

### B. *Procedural Coordination Versus Substantive Consolidation*

If enterprise law were partially adopted, a jurisdiction’s law governing enterprise group insolvency would need to consider whether a multinational enterprise group is, as an ‘economic reality,’ an enterprise group of connected and controlled enterprises or is in fact a series of separate legal and merely related entities. If the group consists of a number of disparate entities, then the separate entity doctrine should be respected. In this case, separate proceedings could be assisted by cooperation and coordination of the proceedings if a single liquidator was appointed to each group member to streamline the proceedings.<sup>192</sup> This approach is referred to as a procedural coordination,<sup>193</sup> where insolvency proceedings are conducted in a joint manner.<sup>194</sup> Coordinating procedures can promote procedural convenience and result in cost-efficiency.<sup>195</sup> The assets and liabilities of each corporate entity are treated separately and remain with the respective entities; but the proceedings are coordinated with a high degree of cooperation between and among courts and liquidators.<sup>196</sup>

If, however, the economic reality of a multinational enterprise group demonstrates that it is an enterprise with intermingled assets and liabilities and extensive ownership and control of its subsidiar-

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190. *Id.* at 340–44.

191. *Id.* at 371.

192. See Legislative Guide Part Three, *supra* note 17, at 27; Mevorach, *Towards a Consensus*, *supra* note 19, at 374–75.

193. See Legislative Guide Part Three, *supra* note 17, at 27–58; Mevorach, *Towards a Consensus*, *supra* note 19, at 377; Samuel L. Bufford, *Coordination of Insolvency Cases for International Enterprise Groups: A Proposal*, 86 AM. BANKR. L.J. 685, 737 (2012).

194. Mevorach, *Towards a Consensus*, *supra* note 19, at 377 n.65.

195. Legislative Guide Part Three, *supra* note 17, at 27.

196. *Id.*

ies, there should be consolidation during insolvency of the group, whether or not every member is insolvent.<sup>197</sup> This approach is referred to as substantive consolidation<sup>198</sup> and closely resembles enterprise law. According to the *Legislative Guide*, substantive consolidation “permits the court, in insolvency proceedings involving two or more enterprise group members, to disregard the separate identity of each group member in appropriate circumstances and consolidate their assets and liabilities, treating them as though held and incurred by a single entity. The assets are thus treated as if they were part of a single estate for the general benefit of all creditors of the consolidated group members.”<sup>199</sup> However, only a few countries have statutory power to order substantive consolidation, thus it is rarely used. Australia’s laws on pooling and holding company liability are nascent examples of this trend.

An examination of United States case law is helpful in understanding the advantages and disadvantages of substantive consolidation. *In Re Am. Camshaft Specialties, Inc.*<sup>200</sup> concerned a voluntary Chapter 11 petition filed by four related entities. American Camshaft wholly owned the other three companies and provided funding for their operations.<sup>201</sup> It was in turn wholly owned by ASIMCO Tech, a Delaware corporation, that was wholly owned by ASIMCO Holding, a Cayman entity that was the parent of a number of entities in the United States, China, and other countries.<sup>202</sup> The four companies, ASIMCO Tech and ASIMCO Holding had the same board of directors.<sup>203</sup> The cases were converted to Chapter 7 proceedings after the companies failed to file a plan, and the companies were under joint administration.<sup>204</sup> The Trustee instituted adversary proceedings with a number of counts including one for substantive consolidation.<sup>205</sup> It was contended that the court had power to order consolidation under Section 105 of the Bankruptcy Code.<sup>206</sup> The court began its analysis by noting that:

[T]here is no Bankruptcy Code section that expressly creates a cause of action in favor of a Chapter 7 trustee or a debtor for

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197. LEGISLATIVE GUIDE ON INSOLVENCY LAW: PART THREE, *supra* note 126, at 60.

198. See LEGISLATIVE GUIDE ON INSOLVENCY LAW: PART THREE, *supra* note 126, at 59–61; Mevorach, *Towards a Consensus*, *supra* note 19, at 377; Bufford, *supra* note 193, at 737–38.

199. Legislative Guide Part Three, *supra* note 17, at 59–60.

200. *In re Am. Camshaft Specialties, Inc.*, 410 B.R. 765 (Bankr. E.D. Mich. 2009).

201. *Id.* at 769.

202. *Id.*

203. *Id.*

204. *Id.* at 770.

205. *Id.*

206. *Id.* at 777.

substantive consolidation. The term substantive consolidation does not appear anywhere in the Bankruptcy Code or the Bankruptcy Rules. It is a judicially created doctrine that treats separate legal entities as if they were merged into a single entity, pooling the assets and liabilities of the two entities, so that the assets of the two entities may result in a common fund available to satisfy the debts of both entities. Fundamentally, it is a judicial doctrine that has been applied by courts to ensure the equitable treatment of all creditors.<sup>207</sup>

The decision is an example of the court using broad powers creatively.

The Bankruptcy Court in *American Camshaft* cited the Sixth Circuit Court of Appeals in *Re Baker & Getty Financial Services*<sup>208</sup> in relation to substantive consolidation. There, the Sixth Circuit was required to consider whether a substantive consolidation order should be given retroactive effect *nunc pro tunc*, not in bankruptcy, but for the purposes of determining what date a preferential transfer was made. The Court of Appeals quoted the Bankruptcy Court decision in *Evans Temple Church of God in Christ & Cmty. Ctr. Inc.*,<sup>209</sup> noting that the court will order substantive consolidation “where the interrelationships of the debtors are hopelessly obscured and the time and expense necessary to attempt to unscramble them is so substantial as to threaten the realization of any net assets for all of the creditors.”<sup>210</sup> In deciding to order consolidation, the court must consider that “the practical necessity of consolidation to protect the possible realization of any recovery for the majority of the unsecured creditors far outweighs the prospective harm to any particular creditor. . . . It is, in effect, a statement by the Court that the assets and liabilities of one debtor are substantially the same assets and liabilities of the second debtor . . . .”<sup>211</sup>

After a thorough survey of the case law, the court made several important observations:

Substantive consolidation is different from piercing the corporate veil or an action to determine if two or more corporations are alter egos of one another.

Substantive consolidation is an independent, judicially created cause of action.

There is no express statutory authority.

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207. *Id.* at 778.

208. *In re Baker & Getty Fin. Servs., Inc.*, 974 F.2d 712, 712 (6th Cir. 1992).

209. *In re Evans Temple Church of God in Christ & Cmty. Ctr. Inc.*, 55 B.R. 976, 981–82 (Bankr. N.D. Ohio 1986).

210. *Id.* at 981.

211. *Am. Camshaft*, 410 B.R. at 779 (citing *Baker & Getty*, 974 F.2d at 720).

Substantive consolidation is an extraordinary remedy to be used sparingly.

There is an impression of an untethered, ad hoc approach in the case law which can greatly diminish predictability.

Actions to substantively consolidate non-debtor entities raise serious due process questions for transacting parties that continue to do business with a non-debtor entity where such creditors are not parties to any action brought to substantively consolidate such non-debtor with a debtor entity.

Due process problems are increased by the inevitable need to determine whether substantive consolidation, if warranted at all, is to be made on a nunc pro tunc basis, further exposing parties presently doing business with a non-debtor entity to shifting and incalculable risks at the time that they do business with such entity.<sup>212</sup>

The Court ruled that it “will only substantively consolidate a non-debtor entity with a debtor where it is shown that either: (i) the debtor and the non-debtor entity in their pre-petition conduct disregarded the separateness of their respective entities so significantly as to lead their creditors to treat them as one legal entity; or (ii) that post-petition, the assets and liabilities of the debtor and the non-debtor entity sought to be consolidated are so hopelessly scrambled and commingled that it is impossible to separate them and tell them apart thereby resulting in harm to all creditors.”<sup>213</sup> It was not persuaded that a shared board of directors was enough to disregard the separateness of the companies.<sup>214</sup> Similarly, the fact that customers regarded it as one large company was not dispositive. Having common financial statements or common presentations of financial information did not change the court’s decision.<sup>215</sup> It concluded that there was no basis for substantive consolidation of the non-debtor defendants with the Debtors.<sup>216</sup>

*In Re New Center Hospital*<sup>217</sup> provides further clarity. The court explained that the case of *Re Augie/Restivo Baking Company, Ltd.* provides a two-prong test whereby the second prong requires a seven-part inquiry into the relationship of the entities as follows:

- (1) presence or absence of consolidated business or financial records;
- (2) unity of interest and ownership between the debtors;

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212. *American Camshaft*, 410 B.R. at 786.

213. *Id.* at 787.

214. *Id.* at 789.

215. *See id.* at 790–91.

216. *Id.* at 791.

217. *In re New Ctr. Hosp.*, 187 B.R. 560 (E.D. Mich. 1995).

- (3) the existence of parent and inter-corporate guarantees on loans;
- (4) degree of difficulty in segregating and ascertaining separate assets and liabilities;
- (5) existence of transfers of assets without observance of corporate or other legal formalities;
- (6) commingling of assets and business functions; and
- (7) the profitability of consolidation at a single principal location.<sup>218</sup>

The net result as seen from the analysis above is that there is considerable uncertainty even in jurisdictions where most of the group's members are located within one jurisdiction. Courts have creatively concocted this doctrine to resolve the gap between the separate personality doctrine and commercial reality of single enterprises, but seem to adopt a variety of tests to sketch the relationship between the entities to determine when their separateness should be disregarded. In addition, there are acknowledged due process problems when non-debtor entities are involved. The degree of difficulty and complexity only rises when dealing with group companies spread across multiple jurisdictions.<sup>219</sup>

### C. *Centre of Main Interests (COMI)*

In cross-border insolvencies, the jurisdiction in which an insolvency proceeding will take place is often determined as the place in which the debtor has its center of main interests (COMI).<sup>220</sup> As such, determining an entity's COMI is often of crucial importance as it will determine the place in which proceedings will commence and the law that will apply. Unfortunately, COMI is an ill-defined concept and one that has caused much controversy in the time that it has been in use. It is often criticized as promoting forum shopping as companies attempt to "shift COMI" to obtain the most advantageous applicable law.<sup>221</sup> Given the inability of courts to

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218. *Id.* at 569.

219. See LEGISLATIVE GUIDE ON INSOLVENCY LAW: PART THREE, *supra* note 126, at 83–85.

220. For a discussion of the development of COMI as the jurisdiction for cross-border insolvencies, see FLETCHER, *supra* note 1, at 350–52, 366–72. In international discussions in relation to cross-border insolvency, particularly in Europe since the 1960s, this jurisdictional anchor has variously been described as the "debtor's 'centre of administration' (*centre des affaires*)" and then its "centre of main interests". Despite the importance of determining COMI in a proceeding, there is a paucity of definition within the various international legal frameworks. There is, however, a concomitant abundance of academic and judicial discussion about the term.

221. See *infra* Part V.D.5 (discussing COMI issues that arose in *In re Bear Stearns High Grade Structured Credit Strategies Enhanced Leverage Master Fund Ltd.*, 374 B.R. 122 (Bankr. S.D.N.Y. 2007)).

provide a conclusive definition of COMI for single entities, finding consensus on the COMI of a group enterprise is a somewhat more complex endeavor and one that has no satisfactory answer to date.

Universalism has been promoted as an appropriate response to cross-border insolvency and the counter to resolving the problems generated by territoriality.<sup>222</sup> In cases of multinational enterprise groups, universalism can only be applied after assessing the COMI of the group.<sup>223</sup> Is it the COMI of the parent company or another enterprise within the group that effectively controls the entire group? An international enterprise group COMI has been discussed at length by Working Group V.<sup>224</sup> It determined that, if a group COMI could be established, it would need to be based upon a number of factors collectively considered.<sup>225</sup> At its 35th session in 2008, it outlined the factors that might be considered in determining a group COMI:

If a group COMI could only be determined for a group that was closely integrated, factors establishing the requisite degree of integration would need to be identified. These might include: *the extent of group members' independence* with respect to financial, management and policy decision-making ('head of the office functions'); *financial arrangements between group members*, includ-

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222. For many practitioners and scholars, the solution to cross-border insolvency problems is to subject an insolvency to one proceeding commenced in the COMI of the debtor with the responsibility for disbursing assets to claimants. This view—universalism—is one pillar of the tripod that divides academic opinion about cross-border insolvency law. The alternative approach to cross-border insolvency is where each country applies its own laws within its own jurisdiction to the assets of the insolvent debtor and distributes the proceeds to local creditors. This is referred to as territorialism, a system characterized by a multiplicity of proceedings. See generally Jay Lawrence Westbrook, *A Global Solution to Multinational Default*, 98 MICH. L. REV. 2276 (2000) (promoting universalism); Lynn M. LoPucki, *The Case for Cooperative Territoriality in International Bankruptcy*, 98 MICH. L. REV. 2216 (2000) (advocating for territoriality).

223. See, e.g., Chapter 15 of the United States Bankruptcy Code adopts the UNCITRAL Model Law on Cross-Border Insolvency. A “foreign main proceeding” is defined in § 1502(4) to mean a foreign proceeding pending in the country where the debtor has the center of its main interests (emphasis added). The effect of recognising a foreign proceeding as a “foreign main proceeding” is dramatic as § 1520 effectuates a stay on the commencement and enforcement of other proceedings against the debtor in the United States. Consequently, the definition of COMI is significant.

224. See FLETCHER, *supra* note 1, at 449 (UNCITRAL “in May 1995 formally approved the preparation of uniform legislative provisions on judicial cooperation in cross-border insolvencies, on court access for foreign insolvency administrators, and on recognition of foreign insolvency proceedings. For this purpose, in line with the established practice of UNCITRAL, an intergovernmental working group was constituted as the Working Group on Insolvency Law.” This Working Group was called Working Group V.).

225. See UNCITRAL, Working Group V (Insolvency Law), *Report of Working Group V (Insolvency Law) on the Work of Its Thirty-Fifth Session*, at 32, U.N. Doc No. A/CN.9/666, (Dec. 2, 2008).

ing capitalization, location of bank accounts and accountancy services; the *division of responsibility* with respect to provision of technical and legal documentation and signature of contracts; *the location where* design, marketing, pricing, delivery of products and *office functions were conducted*; and *third-party perceptions*, in particular those of creditors, *concerning that location*.<sup>226</sup>

There will be situations where it is optimal for proceedings to commence in a jurisdiction other than the COMI of the debtor, for example, to avoid multiplicity of proceedings in circumstances where a reorganization is proposed. The report of Working Group V of its 46th session noted that a group approach facilitating the choice of a forum for strategic purposes could succeed without the need to commence proceedings for every group member.<sup>227</sup> Foreign creditors might be able to make their claim in local proceedings and the court could approximate the result.<sup>228</sup> These have been referred to as “synthetic” proceedings.<sup>229</sup> The Working Group emphasized that it would be important that no creditors or other stakeholders of the group member should be worse off under such a group solution.<sup>230</sup>

EU case law provides some guidance on the determination of COMI in group situations. In *Interedil Srl (in liq.) v. Fallimento Interedil Srl*,<sup>231</sup> the European Court of Justice (ECJ) ruled that “[w]here the bodies responsible for the management and supervision of the company are in the same place as its registered office and the management decisions of the company are taken, in a manner that is ascertainable by third parties, in that place, the presumption . . . that the centre of the company’s main interests is located in that place is wholly applicable.”<sup>232</sup> This confirms the approach taken in relation to COMI in other European cases<sup>233</sup>

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226. UNCITRAL, *Note of the Secretariat at its Thirty-Fifth Session*, at 16, U.N. Doc No. A/CN.9/WG.V/WP.82/Add.4, (Nov. 17–21, 2008) (emphasis added).

227. See UNCITRAL, *Report of Working Group V (Insolvency Law) on the Work of its Forty-Sixth Session*, at 41, U.N. Doc No. A/CN.9/829, (Dec. 15–19, 2014).

228. *Id.*

229. *Id.*

230. See *id.*

231. See Case C/396/09, 2011 E.C.R. 1-9939.

232. *Id.* ¶ 50.

233. See the European Court of Justice decision in the seminal case of *Re Eurofood IFSC Ltd*. Case C-341/04, 2006 E.C.R. 1-3813 ¶ 37 [hereinafter *Eurofood*], where the court stated “[W]here a debtor is a subsidiary company whose registered office and that of its parent company are situated in two different Member States, the presumption laid down in the second sentence of Article 3(1) of the [European Council regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings], whereby the centre of main interests of that subsidiary is situated in the Member State where its registered office is situated, can be rebutted only if factors which are both objective and ascertainable by third parties enable it

that the presumption that a company's central interests are located in the place of its registered office. This is rebutted only by evidence to the contrary that is objective and ascertainable by third parties (such as creditors).<sup>234</sup>

With regard to overcoming this presumption, the ECJ provided factors to be considered in a comprehensive manner, taking account of circumstances of each case: "the places in which the debtor company pursues economic activities and all those in which it holds assets, in so far as those places are ascertainable by third parties."<sup>235</sup>

The ECJ court emphasized the criticality of the location of the company's central administration.<sup>236</sup> The court stated that the presumption of COMI cannot be rebutted if the company's registered office is in the same place as the "bodies responsible for management and supervision of a company . . . and [where] the management decisions of the company are taken, in a manner that is ascertainable by third parties."<sup>237</sup> Merely having assets or contracts in another state is not sufficient to rebut the presumption.

This statement closely reflects enterprise law principles and the two must be considered together. This was further elucidated in the *Bear Stearns* litigation where the court found the following factors salient: "the location of the debtor's headquarters; the location of those who actually manage the debtor (which, conceivably could be the headquarters of a holding company); the location of the debtor's primary assets; the location of the majority of the debtor's creditors or of a majority of the creditors who would be affected by the case; and/or the jurisdiction whose law would apply to most disputes."<sup>238</sup> At a global level, the desire to consolidate proceedings or to conduct multiple proceedings with procedural efficiencies linked to a single liquidator enlivens the normative arguments

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to be established that an actual situation exists which is different from that which locating it at that registered office is deemed to reflect."

234. Case C-396/09, *Interedil srl (in liq.) v. Fallimento Interedil srl*, 2011 E.C.R. I-9939 ¶ 49 ("That requirement for objectivity and that possibility of ascertainment by third parties may be considered to be met where the material factors taken into account for the purpose of establishing the place in which the debtor company conducts the administration of its interests on a regular basis have been made public or, at the very least, made sufficiently accessible to enable third parties, that is to say in particular the company's creditors, to be aware of them.")

235. *Id.* ¶ 52.

236. *Id.* ¶ 47.

237. *Id.* ¶¶ 48–50.

238. *In re Bear Stearns High Grade Structured Credit Strategies Enhanced Leverage Master Fund Ltd.*, 374 B.R. 122, 128 (Bankr. S.D.N.Y. 2007).

for universalism.<sup>239</sup> If proceedings are consolidated, in which jurisdiction should they be conducted? There is a general consensus as evidenced in the Model Law and EU Regulation that the COMI of a single entity should be the place where main proceedings take place.<sup>240</sup> However in a multinational corporate group, there may be no clear COMI available.

#### IV. INTERNATIONAL EFFORTS TO ADDRESS THE INSOLVENCY OF MULTINATIONAL ENTERPRISE GROUPS

##### A. *UNCITRAL Legislative Guide*

In 2005, UNCITRAL developed and published Parts One and Two of its *Legislative Guide* to provide guidance to parliamentarians.<sup>241</sup> Thereafter, in 2012, UNCITRAL published Part Three of the *Legislative Guide*, focusing on the treatment of enterprise groups in insolvency both at a local or domestic level and then at the international level, where more than one entity in a group is situated in a different country.<sup>242</sup> The *Legislative Guide Part Three* provides guidance and recommendations about UNCITRAL's proposed best practices for the insolvency of enterprise groups both locally (within one jurisdiction)<sup>243</sup> and globally (more than two enterprises across jurisdictions).<sup>244</sup> It addresses the treatment of enterprise groups in insolvency and emphasizes cooperation and coordination of proceedings as set out in the Model Law.<sup>245</sup> It suggests as a first step that existing principles of cross-border cooperation between and among courts and insolvency practitioners (such as those established in the Model Law) should apply.<sup>246</sup> The *Guide* argues that this, "may help to facilitate commercial predictability and increase certainty for trade and commerce, as well as fair and

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239. See Westbrook, *supra* note 222 (discussing universalism).

240. 11 U.S.C. §§ 1516, 1520.

241. U.N. COMM'N ON INT'L TRADE LAW, UNCITRAL LEGISLATIVE GUIDE ON INSOLVENCY LAW, at 1, U.N. Sales No. E.05.V.10 (2005), [http://www.uncitral.org/pdf/english/texts/insolven/05-80722\\_Ebook.pdf](http://www.uncitral.org/pdf/english/texts/insolven/05-80722_Ebook.pdf) ("guidance to legislators and other users. . . . It is not intended that the recommendations of a legislative guide be enacted as part of national law as such. Rather, they outline the core issues that it would be desirable to address in that law, with some recommendations providing specific guidance on how certain legislative provisions might be drafted.").

242. LEGISLATIVE GUIDE ON INSOLVENCY LAW: PART THREE, *supra* note 126.

243. *Id.* at 19–82.

244. *Id.* at 83–111.

245. See *e.g.*, *id.* at 100 n.74 ("These recommendations on cooperation are intended to be permissive, not directive and are consistent with the corresponding articles of the UNCITRAL Model Law, articles 25, para. 1 and article 26, para. 1.") (internal citation omitted).

246. *Id.* at 86.

efficient administration of proceedings that protects the interests of the parties, maximizes the value of the assets of group members to preserve employment and minimizes costs.”<sup>247</sup>

This emphasis on cooperation as the first step in resolving enterprise group insolvencies illustrates both the extent of the problem and limits on the available solutions. It is doubtful that merely instigating cooperative procedures will indeed “facilitate commercial predictability and increase certainty for trade and commerce, as well as fair and efficient administration of proceedings that protects the interests of the parties, maximizes the value of the assets of group members to preserve employment and minimizes costs.”<sup>248</sup> It would take a number of strategies in tandem, and levels of cooperation and coordination far in advance of what is currently available, to achieve such lofty goals. However, the *Legislative Guide* provides at least some advice to practitioners, judges, and lawyers on approaches to resolving cross-border insolvencies.

#### B. *Chapters I and II of Part Three – General Features of Enterprise Groups*

Chapter I of the UNCITRAL *Legislative Guide Part Three* defines and outlines the general features of an enterprise group. It discusses the reasons for conducting business using enterprise groups, defines the varying tests of control and ownership in different jurisdictions sufficient to create an enterprise group as opposed to a number of separate legal entities.<sup>249</sup> Part I delineates the two broad approaches to regulating enterprise groups—the separate entity approach, where each entity is regulated as a distinct legal personality with limited liability, and the whole group as a single enterprise approach.<sup>250</sup> The latter approach to regulation treats the group as a “single economic unit that operates to further the interests of the group as a whole, or of the dominant group member, rather than of individual members.”<sup>251</sup> The enterprise group approach reflects the reality of modern business practices in that “[b]orrowing may be conducted on a group basis . . . group members may be permitted to operate at a loss, or be undercapitalized, as part of the overall group financial structure and strategy; assets and liabilities may be moved between group members in various

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247. *Id.*

248. *Id.*

249. *Id.* at 5, 11–16.

250. *See id.* at 16–18.

251. *Id.* at 16.

ways; and intra-group loans, guarantees or other financial arrangements may be entered into on essentially preferential terms.”<sup>252</sup> While this method of conducting business appears to be the common approach, law in most countries still generally respects the entity approach.<sup>253</sup> This schism between the way the law treats an enterprise group and the way that group actually operates is of little effect until a creditor attempts to enforce a debt against a particular entity or that entity within the group becomes insolvent. Depending on the legislative approach adopted by a given country, the law may restrain a response that seeks to pierce the veil of incorporation.

Chapter II of Part Three suggests various means by which an efficient and effective legislation may redress circumstances where it would be appropriate to address an enterprise group as a whole rather than as individual entities. These include the use of substantive consolidation.<sup>254</sup> Many of those suggestions have been incorporated into Australian law in the Corporations Act.<sup>255</sup> Given the head start that corporations have in structuring groups and operating them to best protect single entities within the group, any insolvency law must play catch up if it is to penetrate an extremely thick veil of incorporation.

### C. Chapter III of Part Three – Multinational Enterprise Groups

When one or more of the enterprises within a multinational enterprise group become insolvent, it is likely that a number of separate insolvency proceedings will be commenced in different countries.<sup>256</sup> This, without some intervention, reflects the natural territorialist underpinnings of global insolvency laws.<sup>257</sup> This is its natural state.<sup>258</sup> Each State attempts to open proceedings against the enterprise within its own jurisdiction to recover the assets avail-

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252. *Id.* at 16–17.

253. See generally Blumberg, *The Corporate Entity*, *supra* note 29; Mevorach, *Is the Future Bright*, *supra* note 29.

254. LEGISLATIVE GUIDE ON INSOLVENCY LAW: PART THREE, *supra* note 126, at 59–74. The *Legislative Guide*, as its name suggests, attempts to provide guidance to states on appropriate legislative responses to insolvency issues where appropriate. Part II deals with national solutions to local enterprise groups. Suggestions include those already discussed such as pooling, substantive consolidation orders and holding company liability for insolvent subsidiaries. These can be implemented at a domestic level fairly easily. It is only at the multinational level discussed in Part C that there will be problems legislating.

255. See *infra* Part III.

256. LEGISLATIVE GUIDE ON INSOLVENCY LAW: PART THREE, *supra* note 126, at 84–85.

257. See, e.g., LoPucki, *supra* note 222, at 2218–19.

258. See, e.g., *id.*

able within the jurisdiction and to protect the creditors within that jurisdiction.<sup>259</sup> This pattern is repeated for each enterprise in the country, which has jurisdiction over the enterprise.<sup>260</sup> Dividing the enterprise into separate parts in this way, deprives creditors of obtaining any benefit (if there was to have been one) of a coordinated group solution and could result in a loss of efficiency.<sup>261</sup>

Chapter III of the *Legislative Guide Part Three* addresses the international issues that arise in relation to enterprise groups in insolvency. It notes that the lack of effective legislative regimes dealing with international enterprise group insolvency has “resulted in inadequate and uncoordinated approaches” to the problem.<sup>262</sup> This has impeded the “fair and efficient administration of cross-border insolvencies [and] the protection and maximization of the value of the assets of the insolvent debtor.” Conflicting national laws have created uncertainty as to recognition of proceedings and creditors, how foreign creditors will be treated, and the applicable law. The inadequacy of existing laws and uncertainty as to their application has also caused “associated costs and delays [and] has added a further layer of uncertainty that can affect capital flows and cross-border investment.”<sup>263</sup>

The emphasis of the *Legislative Guide* is clearly on economic efficiency benefits to be had for legislating in this area—specifically, efficiencies that might be wrought by increasing the levels of certainty and predictability in the process and eliminating multiple proceedings.<sup>264</sup> However, the *Legislative Guide* offers only modest solutions based upon increased cooperation and the use of cross-border insolvency agreements. Mevorach has called the limited solutions of increased cooperation outlined in the *Legislative Guide* “universalism doubly modified”<sup>265</sup> but it is probably closer to what LoPucki calls “cooperative territoriality.”<sup>266</sup>

Another solution proposed in the *Legislative Guide* includes reorganizations using cross-border insolvency agreements between and among creditors, debtors, practitioners, and courts. Part III of the

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259. *Id.* at 2218–20; LEGISLATIVE GUIDE ON INSOLVENCY LAW: PART THREE, *supra* note 126, at 84–85.

260. LEGISLATIVE GUIDE ON INSOLVENCY LAW: PART THREE, *supra* note 126, at 84–85.

261. *See, e.g.*, Jay Lawrence Westbrook, *The Control of Wealth in Bankruptcy*, 82 TEX. L. REV. 795, 810–15 (2004).

262. LEGISLATIVE GUIDE ON INSOLVENCY LAW: PART THREE, *supra* note 126, at 83.

263. *Id.*

264. *Id.* at 85–86.

265. Mevorach, *Towards a Consensus*, *supra* note 19, at 422.

266. Lynn M. LoPucki, *Cooperation in International Bankruptcy: A Post-Universalist Approach*, 84 CORNELL L. REV. 696, 702 (1999).

UNCITRAL *Practice Guide*<sup>267</sup> details the use of cross-border insolvency agreements and gives examples of their use. One example is the Lehman Brothers Holdings Inc. (LBHI) enterprise, which entered such a protocol in the Chapter 11 proceedings discussed below.<sup>268</sup>

#### D. *Key Multinational Enterprise Group Insolvencies*

##### 1. *Re Maxwell Communication Corporation PLC*<sup>269</sup>

Maxwell Communication Corporation Plc (Maxwell) was a holding company listed on the London Stock Exchange and tightly controlled by Robert Maxwell until his death on November 5, 1991.<sup>270</sup> Maxwell was registered in England and was managed by a Board of Directors in London. It had over 400 subsidiaries around the world mostly in the media and communications industry.<sup>271</sup> Its principal assets—estimated to be between U.S. \$700 million and \$1 billion—were in the United States, mostly in publishing companies.<sup>272</sup> However, most of its debt emanated from the United Kingdom. Barclays Bank and a United Kingdom bank, National Westminster Bank (NatWest), provided overdraft facilities to Maxwell and, by October 1991, around U.S. \$30 million had been drawn on the Barclays account and approximately U.S. \$50 million on the NatWest account.<sup>273</sup> Both banks had also made significant loans to Maxwell.<sup>274</sup>

In late 1991, Barclays became aware that Maxwell had defaulted on a foreign exchange contract on July 15, 1991.<sup>275</sup> Between mid-October and November 26, 1991, Barclays sought to limit its exposure and required Maxwell to repay the \$30 million owed on the facility by November 25, 1991.<sup>276</sup> Maxwell paid the amount owed on the Barclays overdraft on November 26, 1991.<sup>277</sup>

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267. U.N. COMM'N ON INT'L TRADE LAW (UNCITRAL), PRACTICE GUIDE ON CROSS-BORDER INSOLVENCY COOPERATION, U.N. Sales No. E.10.V6 (2010), [http://www.uncitral.org/pdf/english/texts/insolven/Practice\\_Guide\\_Ebook\\_eng.pdf](http://www.uncitral.org/pdf/english/texts/insolven/Practice_Guide_Ebook_eng.pdf).

268. See *infra* note 366 (discussing the Lehman Brothers Protocol).

269. *In re Maxwell Commc'n Corp. plc*, 170 B.R. 800 (Bankr. S.D.N.Y. 1994).

270. *Id.* at 801.

271. WEIL, GOTSHAL & MANGES LLP, REORGANIZING FAILING BUSINESSES: A COMPREHENSIVE REVIEW AND ANALYSIS OF FINANCIAL RESTRUCTURING AND BUSINESS REORGANIZATION 13–24 (2006).

272. *Barclays Bank Plc v. Homan*, [1993] BCLC 680, 683.

273. *In re Maxwell*, 170 B.R. at 803, 806.

274. *Id.* at 803–04.

275. *Barclays Bank Plc*, BCLC 680 at 683.

276. *In re Maxwell*, 170 B.R. at 803–04.

277. *Id.* at 804.

On October 4, 1991, the Maxwell United States subsidiary, Macmillan Inc. sold one of its subsidiaries, Macmillan Directories for approximately U.S. \$145 million.<sup>278</sup> Macmillan did not receive the proceeds of that sale. Instead, Maxwell used part of the proceeds (\$28 million) to pay down part of the overdraft with NatWest.<sup>279</sup>

On November 1, 1991 (four days before Mr. Maxwell's death) Maxwell sold another of its United States subsidiaries, the computer publishing company QUE, for U.S. \$157.5 million.<sup>280</sup> The proceeds of the sale were deposited in Maxwell's NatWest New York account and then transferred directly to the London branch of NatWest.<sup>281</sup> Most of the proceeds were used to pay down the balance of the NatWest overdraft (U.S. \$51 million) and other debts to banking institutions, including Barclays.<sup>282</sup>

On December 16, 1991, Maxwell filed a petition under Chapter 11 of the United States Bankruptcy Code.<sup>283</sup> The next day, Maxwell also filed for administration under the United Kingdom Insolvency Act of 1986.<sup>284</sup> It was then subject to two primary proceedings in different jurisdictions. The courts in the United Kingdom and the United States were then faced with novel conflict of laws issues. Justice Hoffmann, then of the High Court of the United Kingdom, appointed PriceWaterhouseCoopers (PwC) (the preferred administrator for the banks) as the administrator of Maxwell in the United Kingdom proceedings.<sup>285</sup> PwC sought and was initially awarded an ex parte anti suit injunction from the United Kingdom court (not from Hoffmann J) requiring Maxwell to have the United States proceedings dismissed.<sup>286</sup> The argument on behalf of the banks was that the transfers to Barclays and NatWest would likely be invalidated under United States law on preferences but not under that of the United Kingdom.<sup>287</sup>

According to one lawyer involved in the negotiations, Judge Brozman "was not persuaded that dismissal was the best option, but neither was she anxious to further the hostilities before other ave-

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278. *Id.* at 806.

279. *Id.*

280. *Id.* at 804.

281. *Id.*

282. *Id.* at 806–07. (The US dollar amount is converted from the figure of £27.5 million quoted at 806).

283. *Id.* at 801.

284. *Id.* at 802.

285. See Lord Hoffmann, Cross-Border Insolvency, Address at the 1996 Denning Lecture: Cross-Border Insolvency (Apr. 18, 1996) at 17–18; *In re Maxwell*, 170 B.R. at 802.

286. *In re Maxwell*, 170 B.R. at 804.

287. See *id.* at 807–08.

nues could be explored . . . she gulped and decided to appoint a neutral as her own emissary to investigate whether the world could be made safe for cross-border insolvencies.”<sup>288</sup> She then appointed eminent bankruptcy lawyer Richard Gitlin, as the examiner who was “charged with the task of engaging with the parties and recommending a course of action.”<sup>289</sup> Brozman also appointed Jay Westbrook as a friend of the court who provided advice throughout the proceedings.<sup>290</sup>

On December 31, 1991, Hoffmann J approved a protocol (Protocol) drafted by the parties to the dispute under which the administrators and the examiner agreed to cooperate on the matters in the Protocol.<sup>291</sup> Those matters included both parties seeking the prior consent of the other and, in any event, giving notice to the other and to the Bankruptcy Court of their intent to transact with any other Maxwell subsidiaries.<sup>292</sup> This allowed for an orderly reorganization of the Maxwell group and a sale of the subsidiaries which otherwise might have been jeopardized if either party had grabbed<sup>293</sup> the assets.<sup>294</sup>

On January 15, 1992, Judge Brozman of the Southern District of New York approved the Protocol.<sup>295</sup> In the spirit of cooperation evidenced in the Protocol, Hoffmann recognized the examiner as

288. EVAN D. FLASCHEN, HOW THE MAXWELL SAUSAGE WAS MADE 2 (2014), <http://www.evanflaschen.net/Maxwell%20Sausage.pdf>.

289. *Id.*

290. *In re Maxwell*, 170 B.R. at 807; Jay Lawrence Westbrook, *The Lessons of Maxwell Communication*, 64 FORDHAM L. REV. 2531, 2531 (1996).

291. FLASCHEN, *supra* note 288, at 3.

292. MAXWELL PROTOCOL BETWEEN THE EXAMINER AND THE JOINT ADMINISTRATORS (1991), [http://www.casselsbrock.com/cb/pdf/Maxwell\\_Communication.pdf](http://www.casselsbrock.com/cb/pdf/Maxwell_Communication.pdf).

293. See Lucian Arye Bebchuk & Andrew T. Guzman, *An Economic Analysis of Transnational Bankruptcies*, 42 J. L. & ECON. 775, 777–78 (1999) (“Territoriality, also known in derogatory fashion as the ‘grab rule,’ involves the seizure of assets by the courts of the jurisdiction in which those assets are found at the time of the bankruptcy filing.”).

294. Hoffmann, *supra* note 285, at 18–20. In his remarks, Lord Hoffmann, reflecting on approving what has since become one of the most important decisions in cross-border insolvency said the following:

The administrators therefore found that to get anything done—for example, to raise interim finance to keep the subsidiary companies going—required a great deal of expensive and time-consuming negotiation. So they negotiated an overarching agreement with the Examiner, which was rather grandly called the Protocol, which laid down general lines of demarcation for running the proceedings on both sides of the Atlantic with a view to avoiding delay and duplication of effort. The New York judge had encouraged both the negotiation of the Protocol and co-operation between the Examiner and the English administrators.

The Protocol was brought before me for approval. I think it took me about 20 minutes to read and approve it. I checked to see whether it contained anything which looked like an obvious mistake.

295. *In re Maxwell*, 170 B.R. at 802.

having standing in the United Kingdom Court and Brozman recognized the PwC administrators as comprising the corporate governance of Maxwell.<sup>296</sup>

On July 28, 1992 when Barclays sought to continue its anti-suit injunction in the United Kingdom High Court, Hoffmann dismissed the application and ruled that it was:

sufficient . . . to say that, having regard to the connecting factor provided by the source of the repayment money, a decision by the United States court to assert jurisdiction under sec. 547 would not in my judgment involve, according to English notions, so egregious a claim of extra-territoriality that justice requires that it should be prevented by injunction.<sup>297</sup>

The banks' appeals to the United Kingdom Court of Appeal were dismissed on October 8, 1992.<sup>298</sup> The PwC Maxwell administrators next pursued a claim in the Bankruptcy Court of the Southern District of New York to recover the payments to the banks as preference payments under the United States Bankruptcy Code.<sup>299</sup> When the matter came before Brozman, she was charged with determining whether U.S. law applied to the transfers—a decision that would deprive Barclays, NatWest, and Societe Generale (another creditor bank) of the amounts transferred to them by Maxwell before the Chapter 11 proceedings were filed—or whether the United Kingdom was the more appropriate jurisdiction for settling the claims.<sup>300</sup> Judge Brozman set out the foundations of the proposed plan of reorganization under Chapter 11 and a scheme of arrangement under the administration in the United Kingdom.<sup>301</sup> She evaluated the effectiveness of the cooperation between the parties to date and summarized the progress as follows:

In February 1993, building on what the Protocol had created, the joint administrators, with the concurrence of the examiner, filed their plan of reorganization (plan) and scheme of arrangement (scheme). Although separate plan and scheme documents exist, the plan and scheme are mutually dependent and, in their effect, constitute a single mechanism, consistent with

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296. *Id.*

297. *Barclays Bank Plc v. Homan*, [1993] BCLC 680, 692. Hoffmann J. observed that "It seems to me probable that an English court would regard the transaction as sufficiently connected with England to justify assuming jurisdiction under sec. 239. But it does not follow that it would be unjust or unconscionable for a United States court to assume jurisdiction under sec. 547." *Id.* at 702.

298. *See id.* at 706.

299. *In re Maxwell*, 170 B.R. at 802–03.

300. *Id.* at 807.

301. *Id.* at 802–03.

the laws of both countries, for reorganizing [Maxwell] through the sale of assets as going concerns and for distributing assets to creditors. The disclosure statement accompanying [Maxwell's] plan provided creditors around the world with a summary of the plan and an explanation of the potential for recoveries to creditors from asset dispositions and causes of action, including preferences under U.S. law. Rather than carving up the assets for distribution by the two courts to different groups of creditors, the plan and scheme set up a single 'pot' for distribution to all creditors. In keeping with the single distribution mechanism, creditors were permitted to submit a claim in either jurisdiction which would suffice for participation under both the plan and scheme.<sup>302</sup>

In adjudicating the preference claims, Judge Brozman considered the extraterritoriality of U.S. preference law and concluded that there is a presumption against extraterritoriality in a situation such as Maxwell's—where a foreign debtor makes a preferential payment to another foreign party and the “center of gravity” of the transfer is located overseas.<sup>303</sup>

In relation to the administrator's claim that the payments to the banks were preference payments under the United States Bankruptcy Code, Brozman, relying on Professor Westbrook's assistance to the court, stated that “in an age of multinational corporations, it may be that two (or more) countries have equal claim to be the ‘home country’ of the debtor.”<sup>304</sup> Other factors to be considered by the court included “where the debtor's ‘nerve center,’ assets, and creditors are located and where the debtor's business is primarily conducted.”<sup>305</sup> This is similar to the test later expounded in the European court in *Eurofood*.<sup>306</sup> Judge Brozman also considered the doctrine of comity and the aims of cross-border insolvency law and determined that English law should apply to the preference

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302. *Id.* The judge pointed out that this “was all explained to creditors in [Maxwell's] disclosure statement, which provided in pertinent part that:

A creditor who has a right to claim in the U.S. Chapter 11 case, or who would have a right to claim if [Maxwell] were liquidated under U.K. law . . . can claim under the Plan and Scheme by a single filing in either jurisdiction. The Plan and Scheme permit the forum for resolution of disputed claims against [Maxwell] to be determined on a case by case basis. . . .

The Plan and Scheme provide for a “bar order” equivalent to that normally obtained in US proceedings but also provide for the allowance of late Notices of Claim to the extent that the Administrators or the English Court determine that the creditor's failure to file a Notice of Claim on or before the Claims Date did not result from willful default or lack of reasonable diligence.”

303. *Id.* at 814.

304. *Id.* at 817.

305. *Id.*

306. *See Eurofood, supra* note 233.

claims.<sup>307</sup> She considered that Maxwell was an English company run out of Maxwell House in London and thus subject to an English board of directors.<sup>308</sup> The banks were based in England and the transactions took place in England.<sup>309</sup>

The judge explained that her reasoning was supported by commercial realities and concluded that “[b]ecause there is an insolvency proceeding pending in England, that country’s interest in applying its avoidance laws to transfers made in England by an English corporation to recipients found in England, on account of debt incurred in England, is greater than is this country’s interest in applying U.S. law.”<sup>310</sup>

The Bankruptcy Court then granted the banks’ motions to dismiss the preference claims under the Bankruptcy Code.<sup>311</sup> Judge Brozman ultimately determined that the transfers were extraterritorial and that the Bankruptcy Code did not apply to the claims.<sup>312</sup> In the interests of comity, the court also asked and concluded that England’s “jurisdiction’s laws and policies [were] implicated to the greatest extent.”<sup>313</sup> This decision was appealed to the United States District Court for the Southern District of New York but was dismissed by Judge Scheindlin on grounds of extraterritoriality and comity.<sup>314</sup> An additional appeal to the United States Second Circuit Court of Appeals, affirmed the dismissal.<sup>315</sup> Second Circuit Judge Cardamone stated:

Despite the unusual degree of cooperation and reconciliation of the laws of the two forums, the plan and scheme predictably did not resolve all the problems that might arise from the concurrent proceedings. For example, these documents did not specify which substantive law would govern the resolution of disputed claims by creditors. More importantly, they did not address the instant dispute regarding the debtor’s ability to set aside pre-petition transfers to certain creditors.<sup>316</sup>

The court considered that the proceedings’ connection to England was strong and paid tribute to the unprecedented levels of

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307. *In re Maxwell*, 170 B.R. at 818.

308. *Id.* at 817.

309. *Id.*

310. *Id.* at 818.

311. *Id.*

312. *Id.*

313. *Id.* at 816.

314. *In re Maxwell Commc’n Corp. plc*, 186 B.R. 807, 823–24 (Bankr. S.D.N.Y. 1995) (noting dismissal on Sept. 12, 1995).

315. *In re Maxwell Commc’n Corp. plc by Homan*, 93 F.3d 1036 (2d Cir. 1996).

316. *Id.* at 1042.

cooperation demonstrated throughout the proceedings.<sup>317</sup> It also acknowledged the academic divergence present in cross-border insolvency situations such as this one.<sup>318</sup>

## 2. Bank of Credit and Commerce International SA

The Bank of Credit and Commerce International SA (BCCI SA) was incorporated in Luxembourg in 1972. It had offices in a number of countries including London, Dubai and Abu Dhabi. In 1977 it had 146 branches in 43 countries and in the mid-1980s had balance sheet assets totaling around \$22 billion.<sup>319</sup> In late 1975, the Bank of Credit and Commerce Holdings (Luxembourg) SA (BCH) was formed as a holding company of both BCCI SA (still incorporated in Luxembourg), and Bank of Credit and Commerce International Overseas Ltd. (Overseas) incorporated in the Grand Cayman Islands.<sup>320</sup> In 1976, BCCI moved its head office to London but kept its seat of incorporation in Luxembourg.<sup>321</sup> It was registered in England as a foreign corporation “under Pt XXIII of the

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317. *Id.* at 1053 (“In addition to the relative strength of the respective jurisdictional interests of England and the United States, there is a compelling systemic interest pointing in this instance against the application of the Bankruptcy Code. These parallel proceedings in the English and American courts have resulted in a high level of international cooperation and a significant degree of harmonization of the laws of the two countries. The affected parties agreed to the plan and scheme despite differences in the two nations’ bankruptcy laws. The distribution mechanism established by them—beyond addressing some of the most obvious substantive and procedural incongruities—allowed Maxwell’s assets to be pooled together and sold as going concerns, maximizing the return to creditors. And, by not requiring a creditor to file its claim in both forums, the arrangement eliminated many of the inefficiencies usually attendant in multi-jurisdiction proceedings.

. . . This collaborative effort exemplifies the “spirit of cooperation” with which tribunals, guided by comity, should approach cases touching the laws and interests of more than one country.”) (internal citations omitted).

318. *Id.* (“We recognize that forbearance and goodwill in the conduct of international bankruptcies is an ideal not easily achieved in the near-term. Many commentators advocate centralized administration of each insolvency under one country’s laws, which could require a multi-lateral treaty or, even, a greater degree of harmonization of the commercial laws throughout the world. . . . In the meanwhile, bankruptcy courts may best be able to effectuate the purposes of the bankruptcy law by cooperating with foreign courts on a case-by-case basis. Congress contemplated this approach when it provided for “ancillary” proceedings under 11 U.S.C. § 304. Although comity analysis admittedly does not yield the commercial predictability that might eventually be achieved through uniform rules, it permits the courts to reach workable solutions and to overcome some of the problems of a disordered international system.”).

319. Patricia J. Arnold & Prem Sikka, *Globalization and the State-Profession Relationship: The Case the Bank of Credit and Commerce International*, 26 *ACCT. ORG. & SOC’Y* 475, 480–81 (2001).

320. *Re Bank of Credit and Commerce Int’l SA (BCCI No. 10)* [1996] 4 All ER 796, 800–01.

321. *Id.*

Companies Act 1985 or its predecessors.”<sup>322</sup> Overseas was never registered in England.<sup>323</sup> According to the judgment of Judge Raftery in *BCCI (No. 9)*, at the time that winding up proceedings were commenced, BCCI SA had “24 of its 47 offices in the United Kingdom but Overseas had 63 offices in 28 different countries, most of which were in Oman.”<sup>324</sup> BCCI was engaged in a web of criminal activity across multiple jurisdictions.<sup>325</sup>

The issue in dispute in *BCCI (No. 10)* was whether the liquidators should apply the English Insolvency Rules 1986 to set off claims by English creditors.<sup>326</sup> There was a clear benefit to English creditors if English, and not Luxembourg, law applied.<sup>327</sup> In this instance, the court relied upon an agreement between the liquidators to determine jurisdiction.<sup>328</sup> The novel strategy used by the court in the BCCI liquidation offers a potential solution to apply in other similar situations.

Because of the complexity of the structures of the global BCCI entities, the liquidators in Luxembourg, England, and the Cayman Islands proceedings, entered into a number of agreements outlining cooperation agreements.<sup>329</sup> In earlier proceedings, Sir Donald Nicholls, Vice Chancellor of the High Court of England, author-

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322. *Re Bank of Credit and Commerce Int'l SA (BCCI No. 9)* [1994] 3 All ER 764, 769.

323. *BCCI No. 10*, 4 All ER 796, at 801.

324. *BCCI No. 9*, 3 All ER 764, at 770.

325. JOHN KERRY & HANK BROWN, A REPORT TO THE COMMITTEE ON FOREIGN RELATIONS UNITED STATES SENATE, S. REP. NO. 102-140 (1992) (“BCCI’s unique criminal structure—an elaborate corporate spider-web with BCCI’s founder, Agha Hasan Abedi and his assistant, Swaleh Naqvi, in the middle—was an essential component of its spectacular growth, and the cause of its eventual collapse. The structure was conceived by Abedi and managed by Naqvi for the specific purpose of evading regulation or control by governments. It functioned to frustrate the full understanding of BCCI’s operations by anyone.

Unlike any ordinary bank, BCCI was from its earliest days made up of multiple layers of entities, related to one another through an impenetrable series of holding companies, affiliates, subsidiaries, banks-within-banks, insider dealings and nominee relationships. By fracturing corporate structure, record keeping, regulatory review, and audits, the complex BCCI family of entities created by Abedi was able to evade ordinary legal restrictions on the movement of capital and goods as a matter of daily practice and routine. In creating BCCI as a vehicle fundamentally free of government control, Abedi developed in BCCI an ideal mechanism for facilitating illicit activity by others, including such activity by officials of many of the governments whose laws BCCI was breaking.”).

326. *BCCI (No. 10)*, 4 All ER 796, at 800. One issue in the case was whether Luxembourg or English laws in relation to set off would apply. If Luxembourg law was to apply, the English creditors would not receive the advantage of the debts they owed being set off against the debts owing to them before the assets were sent to Luxembourg for distribution to creditors.

327. *See id.* at 803.

328. *Id.* at 805-08.

329. *Id.* at 804.

ized the agreements—including a Pooling Agreement under which the assets and liabilities of BCCI and Overseas would be pooled and a Contribution Agreement under which certain shareholders agreed to contribute to the pool of assets.<sup>330</sup> When the Pooling Agreement first came before the English Court for approval, Sir Donald Nicholls stated that, “I should approve them without further ado. I am satisfied that the affairs of BCCI S.A. And BCCI Overseas are so hopelessly intertwined that a pooling of their assets . . . is the only sensible way to proceed.”<sup>331</sup>

The Court in *BCCI (No. 10)* recognized the importance of the Pooling Agreement. It stated:

The most important agreement of all for present purposes is the pooling agreement. It was, for reasons I have already indicated, well understood by each set of liquidators that co-operation between them was essential if the winding up was not to be lost in a morass of legal argument. Their objective was to create a structure under which all BCCI assets would be pooled, the tracing and recovery of assets would be a joint enterprise and creditors in each liquidation would receive the same level of dividend from a central pool.<sup>332</sup>

The BCCI liquidation lasted 21 years and concluded on May 17, 2012. The costs of the liquidation totaled approximately \$1.7 billion, including fees of \$656 million to the two accounting and law firms that managed the process.<sup>333</sup> The liquidators were able to recover \$8.5 billion of deficient funds, initially estimated to be more than \$10 billion.<sup>334</sup>

### 3. Re Stanford International Bank

The most compelling argument for global cross-border insolvency reform is *Re Stanford International Bank Ltd.*<sup>335</sup> Stanford International Bank (SIB) was incorporated in Antigua and Barbuda in 1990.<sup>336</sup> It was effectively a front for an international Ponzi scheme orchestrated and run by Allen Stanford (Stanford), which began

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330. *Re BCCI (No. 2)* [1992] BCC 715.

331. *Re BCCI* [1992] BCLC 570.

332. *BCCI No. 10*, 4 All ER 796, at 805.

333. See Simon Bowers, *Files Close on BCCI Banking Scandal*, *GUARDIAN* (May 17, 2012), <http://www.theguardian.com/business/2012/may/17/files-close-bcci-banking-scandal>.

334. See Steve Lohr, *Abu Dhabi Agrees to Give B.C.C.I. Creditors \$2.2 Billion*, *N.Y. TIMES* (Feb. 22, 1992), <http://www.nytimes.com/1992/02/22/business/abu-dhabi-agrees-to-give-bcci-creditors-2.2-billion.html>.

335. *Re Stanford Int'l Bank (Stanford No. 1)* [2009] EWHC 1441 (Austl.).

336. *Id.* ¶ 1.

operating in 1999.<sup>337</sup> Under the scheme, investors, primarily from North, Central, and South America, purchased certificates of deposit (CDs) in SIB.<sup>338</sup> Approximately U.S. \$10 billion in CDs were sold to more than 21,000 investors in approximately 113 different countries.<sup>339</sup> As is the case in simple Ponzi schemes, money ‘invested’ by later ‘investors’ was used to pay redemptions and interest on earlier deposits.<sup>340</sup> It is estimated that, at the time of the appointment of the receiver, around U.S. \$10 billion in CDs had been invested in a Ponzi scheme with approximately U.S. \$5.6 billion paid as CD redemptions and interest.<sup>341</sup> Additionally, a large number of investors attempted to redeem their security deposits at the time of the 2008 financial crisis, exposing the Ponzi scheme.<sup>342</sup> After accounting for the amounts paid as interest and redemptions, approximately U.S. \$4.4 billion was outstanding.<sup>343</sup> The liquidators appointed by the Antiguan and Barbudan courts identified approximately U.S. \$826 million in assets, leaving over U.S. \$3 billion unaccounted for.<sup>344</sup>

On February 17, 2009, the United States Securities and Exchange Commission (SEC) filed a lawsuit against Allen Stanford, SIB, Stanford Group Company, and Stanford Capital Management, LLC (Stanford Companies), among others.<sup>345</sup> In the ensuing four years a global dispute emerged between competing representatives regarding control of the liquidation of the Stanford companies.<sup>346</sup> According to the settlement agreement entered into by the parties on March 12, 2013, the United States District Court appointed an equity receiver (Receiver) on February 16, 2009; the Receiver was “authorized to take possession, custody and control of the Stanford

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337. *Velasquez v. Stanford International Bank* (Velasquez), The Eastern Caribbean Supreme Court in the High Court of Justice Antigua and Barbuda, Case No ANUHCV 2009/0149, 28 October 2013 ¶ 23; *Stanford No. 1*, EWHC 1441 ¶ 29.

338. *Stanford No. 1*, EWHC 1441 ¶¶ 15–17.

339. SEC v. Stanford Int’l Bank, Ltd., 776 F. Supp. 2d 323 (N.D. Tex. 2011); Amended Joint Motion of the SEC, Receiver, Examiner, and Official Stanford Investors Committee to Approve Settlement Agreement and Cross-Border Protocol and Brief in Support, *In re Stanford International Bank, Ltd.*, 3:09-CV-0721-N, at 2 (N.D. Tex. Mar. 12, 2013) [hereinafter Settlement Agreement], <http://www.stanfordfinancialreceivership.com/documents/Amnd Mtn for Approval of Settlement Agreement.pdf>.

340. Second Amended Complaint, SEC v. Stanford Int’l Bank, Ltd., 3:09-CV-0298-N, at 4 (N.D. Tex. June 19, 2009), [http://www.stanfordfinancialreceivership.com/documents/2nd\\_Amended\\_Complaint.PDF](http://www.stanfordfinancialreceivership.com/documents/2nd_Amended_Complaint.PDF).

341. *Velasquez*, *supra* note 337, ¶ 22.

342. *Id.* ¶¶ 14–15.

343. *Id.* ¶ 22 (\$10 billion minus \$5.6 billion).

344. *Id.*

345. Settlement Agreement, *supra* note 339, at 2; *Stanford No 1*, EWHC 1441 ¶ 1.

346. Settlement Agreement, *supra* note 339, at 3.

Receivership Estate, including all domestic and foreign assets of R. Allen Stanford, SIB, Stanford Group Company, and other Stanford entities.”<sup>347</sup>

At the same time, the Eastern Caribbean Supreme Court in Antigua (Antiguan Court) issued an order appointing two Joint Liquidators of SIB (JLs), and specifying that the the liquidators’ powers extend over the assets and affairs of SIB and the Stanford Trust Company.<sup>348</sup> As stated in the settlement agreement, “the court-appointed U.S. Receiver and Antiguan JLs share many of the same goals: to collect all of the Stanford assets and to develop and pursue legal claims related to those assets, in order to maximize the victims’ recoveries.”<sup>349</sup> However, those goals, while noble, conflicted sharply with the individual aims of the Receiver and the Liquidators, who sought to gain control of the ultimate liquidation on behalf of the United States and Antigua and Barbuda respectively.<sup>350</sup> This was a quintessential multinational cross-border dispute.

The issues that flowed from authorizing both a Receiver and Liquidators governed by two separate courts in different countries are perhaps, in hindsight, obvious. They are best exemplified by looking at the dispute, which arose in the United Kingdom when both parties approached the High Court for recognition under the Cross-border Insolvency Regulations 2006 (UK) (CBIR).<sup>351</sup> *Re Stanford International Bank*,<sup>352</sup> Judge Lewison of the United Kingdom High Court considered the issues pertinent to determining COMI under the CBIR and found that:

The main contest under this head is which of the Receiver and the Liquidators should take control of SIB’s assets within the jurisdiction and, if the Liquidators, whether they should be permitted to remit those assets (or any realisation of them) to Antigua. In view of the policy in favour of a single liquidation I consider that the Liquidators, who have been properly appointed as liquidators by the courts of SIB’s place of incorporation, should take possession of SIB’s assets within the jurisdiction and that they should be permitted to remit those assets (or any realisation of them) to Antigua.<sup>353</sup>

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347. *Id.* at 2.

348. *Id.* at 2–3.

349. *Id.* at 3.

350. *Id.*

351. *See generally* The Cross-Border Insolvency Regulations, 2006, S.I. 2006/1030 (U.K.).

352. *Stanford No. 1*, EWHC 1441.

353. *Id.* ¶ 108.

The matter was quickly appealed to the Court of Appeal.<sup>354</sup> The Court of Appeal upheld the decision of the High Court in favour of the Antiguan Liquidators.<sup>355</sup>

There are a number of contentious issues surrounding the interpretation of the UNCITRAL Model Law on Cross-Border Insolvency,<sup>356</sup> particularly in relation to COMI. The approximately eight issues resulting from the decision of the Court of Appeal is a testament to the need for greater certainty in this area.

The Receiver sought to appeal the decision of the Court of Appeal in the Supreme Court.<sup>357</sup> The Receiver and the Liquidators were also involved in similar disputes about recognition in Canada and Switzerland.<sup>358</sup> In Canada, perhaps not surprisingly, the Ontario Court of Justice was prepared to recognise the Receiver as the appropriate representative after having initially recognised the Liquidators.<sup>359</sup> This lies in contrast to the approach taken in the United Kingdom. The parties, perhaps sensing the futility of continuing this approach, sought to settle their differences.<sup>360</sup>

In the preamble to the final settlement agreement, the parties noted that until May 2012, the parties “were litigating issues concerning the control, liquidation and distribution of Stanford assets in no less than eight countries on three continents.”<sup>361</sup> The *raison d’être* for the settlement agreement was to reduce costs and maximise recoveries.<sup>362</sup>

354. *Re Stanford Int’l Bank* [2010] EWCA (Civ) 137 (Austl.); [2011] Ch 33 (*Re Stanford*) (Austl.).

355. See Look Chan Ho, *Misunderstanding the Model Law: Re Stanford International Bank*, 26 J. INT’L BANKING & FIN. L. 395, 404 (2011).

356. Implemented in the United States as Chapter 15 of the Bankruptcy Code.

357. Settlement Agreement, *supra* note 339, at 4.

358. *Id.* at 3–5.

359. *Id.* at 4.

360. See *id.* at 1.

361. *Id.* at 6.

362. *Id.* at 7–9. The reasons provided include:

The Settlement Agreement resolves four years of expensive and timeconsuming litigation in the United States, United Kingdom, Canada, and Switzerland. Without the Settlement Agreement, this burdensome litigation will continue for years and reduce the assets available for distribution to the victims.

...

The Settlement Agreement creates a plan for the distribution of almost 90% of the frozen assets from the UK, Canada, and Switzerland, from which distributions will be made as soon as the necessary approvals are obtained from the pertinent authorities in those countries.

...

The Settlement Agreement facilitates cooperation and coordination of efforts between the parties with respect to litigation, asset recovery efforts, and monetization of these assets. Without the Settlement Agreement, the parties will be unable

Once again, it was left to the disputing parties to rise above their strict legal entitlement under the Model Law and to reach a sensible way of working. Until there is greater certainty in the interpretation and application of the Model Law, or until a truly global law can be implemented, parties in future disputes such as those in *Re Stanford* may seek to settle matters sooner rather than later.

#### 4. Lehman Brothers Holding Inc.

The collapse of Lehman Brothers Holding Inc. (LBHI) illustrates the perils of cross-border insolvency of a multinational enterprise group on an unprecedented scale. On September 15, 2008, LBHI and 22 of its affiliate companies filed for relief under Chapter 11 of the United States Bankruptcy Code in the United States Bankruptcy Court for the Southern District of New York.<sup>363</sup> At the time, Lehman Brothers operated in over 40 countries through more than 650 legal entities outside of the United States.<sup>364</sup> The investment bank's collapse resulted in more than 75 proceedings with more than 16 administrators exercising multiple roles.<sup>365</sup> The insolvency practitioners responsible for the resolution of Lehman Brothers' Bankruptcy prepared a Cross-Border Insolvency Protocol, the stated purpose of which was to facilitate cooperation among administrators and the coordination of multiple proceedings.<sup>366</sup> Its intended benefits are set out in that document as follows:

Given the integrated and global nature of Lehman's businesses, many of the Debtors' assets and activities are spread across different jurisdictions, and require administration in and are subject to the laws of more than one Forum. The efficient administration of each of the Debtors' individual Proceedings would benefit from cooperation among the Official Representatives. In addition, cooperation and communication among

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to achieve similar efficiencies in administering the receivership, or to maximize the funds available for distribution to the victims.

...

The Settlement Agreement provides for coordination of the Receiver's and JJs' claims and distribution processes. Without this Settlement Agreement, the Receiver and the JJs will incur significantly higher administrative costs and the victims' recoveries will be smaller and less consistent.

363. *General Information – Lehman Brothers Holdings Inc., EPIQ Sys.*, <http://dm.epiq11.com/LBH/Project> (last visited Sept. 20, 2015).

364. ALVAREZ & MARSAL, LEHMAN BROTHERS HOLDINGS INC. INTERNATIONAL PROTOCOL PROPOSAL 4 (2009), <http://dm.epiq11.com/LBH/Document/GetDocument/1131024>.

365. *Id.*

366. *See* CROSS-BORDER INSOLVENCY PROTOCOL FOR THE LEHMAN BROTHERS GROUP OF COMPANIES 3 (2009) [hereinafter LEHMAN PROTOCOL], <http://www.ekvandoorne.com/files/CrossBorderProtocol.pdf>.

Tribunals, where possible, would enable effective case management and consistency of judgments.<sup>367</sup>

The complexity of the Lehman Brothers liquidation was illustrated in an article in *A+* magazine in 2010, featuring the KPMG liquidators appointed to Lehman Brothers' Hong Kong affiliates.<sup>368</sup> In it, Eddie Middleton, one of the liquidators, was quoted as saying “[i]n a job of this scale, you achieve a lot in the first 18 months to 3 years, and then you get into the depths. Like any other liquidation, you end up with the hard core of assets that are very difficult to realize and the hard core liabilities that are difficult to quantify and litigate.”<sup>369</sup> Quoting Middleton extensively, the article summarized the typical insolvency as one in which creditors are asked to prove their claims item-by-item from the beginning of their relationship with the failed company. But Middleton noted that if that type of process were tried in Lehman's case, it would have taken many years—if it was even possible.<sup>370</sup> “You are talking about millions of transactions, with balances brought forward over a number of years. It's not sensible to expect to prove the claim from the bottom up.”<sup>371</sup> Middleton also stated that sorting out “who owed what to whom was ‘frighteningly difficult’ at first. Lehman's Hong Kong entities had around 2,500 listed equity investments and about 2,700 derivative trades at the time of bankruptcy.”<sup>372</sup> Lehman Brothers Asia Holdings, for example, had U.S. \$12.6 billion of intercompany Accounts Receivable, the largest of which was from Lehman Brothers Japan.<sup>373</sup> Douglas Fergusson, another partner at KPMG stated that “[w]e quickly formed a team with a mixed skills set, including due diligence professionals and people who are really good at making sense of disjointed information. We also had our own valuations team and tax teams heavily involved.”<sup>374</sup>

The author of the Liquidating Lehman article noted that the 70-strong team working on the Lehman Brothers liquidation had to grapple with the more than 900 Lehman entities that operated in over 40 countries.<sup>375</sup> Further complicating the matter is the com-

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367. *Id.* at 2.

368. See HEDA BAYRON, LIQUIDATING LEHMAN 23 (2010) [hereinafter LIQUIDATING LEHMAN], <https://www.kpmg.com/CN/en/PressRoom/Documents/201005-A-Plus.pdf>.

369. *Id.* at 23.

370. *Id.*

371. *Id.*

372. *Id.*

373. *Id.*

374. *Id.*

375. *Id.* at 24.

plexity of Lehman's products, particularly the short term repurchase (repo) transactions, which make it difficult to determine the Lehman entity responsible in the transactions. Middleton states that "[t]he way Lehman structured itself and dealt with itself add another thick layer of confusion and complication."<sup>376</sup>

As can be seen, the transaction costs inherent in the uncertainty and sheer complexity of the liquidation have driven the insolvency professionals to resolve the liquidation by attempting to have the highest means of cooperation and coordination between and among themselves and the courts.<sup>377</sup> Middleton noted that:

The way Lehman operated as a single homogenous enterprise is fine when you're a going concern. But when the music stops, that enterprise gets cut up into each separate legal entity and that creates difficulty in a sense of having to unwind all the multitudinous intercompany relationships. . . . Getting to grips with that position is most challenging.<sup>378</sup>

Creditors continue to face difficulties because of the divergent legal regimes and complexity of the transactions—Lehman Australia's creditors had to fight for over seven years before recently prevailing through a tactical use of local litigation.<sup>379</sup> At a global level, over \$106 billion has been recovered by creditors of the investment bank and over \$120 billion has been recovered from the brokerage unit of the group.<sup>380</sup> Courts in several jurisdictions are still grappling with difficult legal issues and it is not possible to do justice to the tricky problems generated by this enterprise group insolvency in this article.<sup>381</sup>

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376. *Id.*

377. LEHMAN PROTOCOL, *supra* note 366.

378. BAYRON, *supra* note 368, at 25.

379. Tony Boyd, *Lehman Bros Settlement Releases \$500m to Creditors*, FINANCIAL REVIEW (Dec. 17, 2015 7:20 PM), <http://www.afr.com/brand/chanticleer/lehman-bros-settlement-releases-500m-to-creditors-20151217-glq8go> ("Time delay can be an effective tool to force commercial negotiations, but in the case of the dispute on one transaction, differences in laws in the US and Australia, a legal finding or the threat of a finding was needed as a lever to have settlement discussions. Without a 'hometown' lever, completion of the Australian Estate could have stagnated indefinitely.").

380. *Lehman Creditors' Recovery May Soon Reach \$7.8 Billion*, REUTERS (July 13, 2015 1:10 PM), <http://www.reuters.com/article/us-lehman-creditors-idUSKCN0PN21S20150713>; Joseph Checkler, *Lehman Increases Money Recovery Estimate to \$92.2 Billion*, WALL ST. J. (July 30, 2015 3:34 PM), <http://www.wsj.com/articles/lehman-increases-money-recovery-estimate-to-92-2-billion-1438284880>.

381. See e.g., Evan Weinberger, *Lehman Sues Lender over Faulty Mortgage Sales*, LAW 360 (Feb. 5, 2016), <http://www.law360.com/articles/755362/lehman-sues-lenders-over-faulty-mortgage-sales>; Jonathan Stempel, *JPMorgan to Pay \$1.42 Billion Cash to Settle Most Lehman Claims*, REUTERS (Jan. 25, 2016 10:53 PM), <http://www.reuters.com/article/us-jpmorgan-lehman-idUSKCN0V4049>; Mark Lawford & Chris Evans, *Protected: UK High Court Judgment on Lehman Waterfall II Application, Parts A and B*, LEXOLOGY (Aug. 4 2015), <http://>

Lehman illustrates that the commercial reality for multinational enterprise groups that effectively function as one unit is not accommodated by legal rules. In such circumstances, parties must fashion cooperative solutions with the assistance of innovative judges. Clearly, the existence of rules would aid predictability, reduce the burden on courts, and make the task of achieving cooperation smoother.

##### 5. The Bear Stearns High-Grade Structured Credit Strategies Master Fund<sup>382</sup>

Bear Stearns was founded in 1923 as an equity-trading house.<sup>383</sup> Originally a partnership, Bear Stearns & Company and Subsidiaries was incorporated in 1985 as Bear Stearns & Company, Inc., a subsidiary of the holding company Bear Stearns Companies, Inc.<sup>384</sup> Bear Stearns opened offices in most major cities in the United States.<sup>385</sup> It also opened international offices in Amsterdam, Geneva, Paris, London, Latin America, Hong Kong, and Tokyo.<sup>386</sup> Its principal subsidiaries were Bear Stearns & Company, Inc.; Custodial Trust Co.; Bear Stearns Mortgage Capital Corp.; Bear Stearns Fiduciary Services, Inc.; Bear Stearns International, Ltd.; Bear Stearns Asia Ltd.; Bear Stearns S.A.; Bear Stearns, Ltd. (Japan); Bear Stearns Securities Corp.; Correspondent Clearing; Bear Stearns Home Loans Ltd.<sup>387</sup>

In 2003, Bear Stearns launched the first of its mortgage-focused hedge funds, High-Grade Structured Credit Strategies Fund (High Grade); in 2006, it launched its second, High-Grade Structured Credit Strategies Enhanced Leverage Fund (Enhanced).<sup>388</sup> The Funds were Cayman Islands exempted limited liability companies

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[www.lexology.com/library/detail.aspx?g=73c4ab94-dc24-4b30-8453-2c7448c6feed](http://www.lexology.com/library/detail.aspx?g=73c4ab94-dc24-4b30-8453-2c7448c6feed); *High Court Concludes that Swiss Insolvency Proceedings Against Lehman Brothers Excluded from the Lugano Convention*, BRICK COURT CHAMBERS (Jan. 17, 2014), <http://www.brickcourt.co.uk/news/detail/High-Court-concludes-that-Swiss-insolvency-proceedings-against-Lehman-Brothers-excluded-from-the-Lugano-Convention>.

382. *In Re Bear Stearns High Grade Structured Credit Strategies Enhanced Leverage Master Fund Ltd.*, 374 B.R. 122 (Bankr. S.D.N.Y. 2007).

383. See *Bear Stearns Companies, Inc.*, ENCYCLOPEDIA, [http://www.encyclopedia.com/topic/Bear\\_Stearns\\_Companies\\_Inc.aspx](http://www.encyclopedia.com/topic/Bear_Stearns_Companies_Inc.aspx) (last visited Oct. 30, 2015).

384. *Id.*

385. *Id.*

386. *Id.*

387. *Id.*

388. Complaint ¶¶ 29, 34, SEC v. Cioffi, No. 08 Civ. 2457 (E.D.N.Y. June 19, 2008), <https://www.sec.gov/litigation/complaints/2008/comp20625.pdf>.

with registered offices in the Cayman Islands.<sup>389</sup> Both dealt in risky mortgage-backed securities.<sup>390</sup> As mortgage defaults increased from around 2005, the Funds began to suffer large losses on their investments.<sup>391</sup> Regardless, Bear Stearns increased its investment in the mortgage-backed securities businesses.<sup>392</sup> By the time of the 2007 sub-prime crisis, the Funds' overexposure to the mortgage market saw them "suffer a significant devaluation of their asset portfolios. The devaluation of those secured assets led to margin calls from many of their trade counterparts, which the Funds were ultimately unable to meet."<sup>393</sup> On July 30, 2007, the Funds filed petitions in the Cayman Grand Court—seeking to be wound up under the Companies Law of the Cayman Islands.<sup>394</sup> The Petitioners then filed an application in the Bankruptcy Court of the Southern District of New York seeking orders under Chapter 15 of the United States Bankruptcy Code (the Model Law) that the Cayman Islands proceedings were foreign main proceedings,<sup>395</sup> as the Cayman Islands was the Funds' center of main interests.<sup>396</sup> If the application was successful and the foreign proceedings were recognized as foreign main proceedings, then the Funds would be entitled to the mandatory stays available under Section 1520 and other discretionary relief under Section 1521.<sup>397</sup>

Judge Lifland was charged with determining whether the COMI was in the Cayman Islands, as that was the place of registration or whether there were facts to show that the presumption in § 1516 was rebutted.<sup>398</sup> He found that there was evidence to rebut the presumption because there were no employees in the Caymans, the operations were being administered from the United States, books and records were maintained in the United States, and all the liquid assets were located there.<sup>399</sup> Further, the judge noted that:

Although two of the three investors in the High Grade Fund are also registered Cayman Islands companies, Mr Whicker, one of

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389. *In re* Bear Stearns High-Grade Structured Credit Strategies Enhanced Leverage Master Fund Ltd., 374 B.R. 122, 124 (Bankr. S.D.N.Y.).

390. *See id.*

391. *See id.* at 125.

392. *See* SEC Complaint, *supra* note 388, ¶¶ 34–36.

393. *In re* Bear Stearns, 374 B.R. at 125.

394. *Id.*

395. *See* 11 U.S.C. § 1502(4) (2012).

396. *See In re* Bear Stearns, 374 B.R. at 122.

397. 11 U.S.C. §§ 1520–1521 (2012).

398. *In re* Bear Stearns, 374 B.R. at 129–30.

399. *Id.* at 130.

the JPLs, testified that both are Bear Stearns entities which appear to have the same minimum Cayman Islands profile as do the Funds. The sole investor in the enhanced fund is a United Kingdom entity. . . . Investor registries are maintained and located in the Republic of Ireland; accounts receivables are located throughout Europe and the United States; counterparties to master repurchase and swap agreements are based both inside and outside the United States but none are claimed to be in the Cayman Islands. Moreover, there apparently exists the possibility that pre-petition transactions conducted in the United States may be avoidable under US law.<sup>400</sup>

The judge concluded that the COMI of the funds was in the United States, because that was “the place where the Funds conduct the administration of their interests on a regular basis and [was] therefore ascertainable by third parties . . . and, more specifically, is located in this district where principle interests, assets and management are located.”<sup>401</sup>

On appeal, the Funds argued that Judge Lifland’s decision “failed to accede to the principles of comity and cooperation . . . [and] that the COMI presumption was erroneously interpreted.”<sup>402</sup> The appeals judge, Judge Sweet, stated that “requiring recognition as a condition to nearly all court access and consequently as a condition to granting comity distinguishes Chapter 15 from its predecessor Section 304. Prior to the enactment of Chapter 15, access to the United States courts by a foreign representative was not dependent on recognition; rather, all relief under section 304 was discretionary and based on subjective, comity-influenced factors.”<sup>403</sup> The judge stated that the “rebuttable presumption at no time relieves a petitioner of its burden of proof/risk of non-persuasion. . . . In fact, Congress changed the relevant language of the Model Law by substituting rebuttal by ‘evidence’ to the contrary for the Model Law’s ‘proof’ to the contrary in order to clarify this very issue. House Report at 112–13 (“The word ‘proof’ in subsection (3) has been changed to ‘evidence’ to make it clearer using United states terminology that the ultimate burden is on the foreign representative.”)<sup>404</sup>

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400. *Id.*

401. *Id.* at 129–30.

402. *In re* Bear Stearns High-Grade Structured Credit Strategies Master Fund, Ltd., 389 B.R. 325, 330 (Bankr. S.D.N.Y. 2008).

403. *Id.* at 333.

404. *Id.* at 335–36.

The District Court subsequently affirmed Judge Lifland's decision.<sup>405</sup>

## V. NORTEL NETWORKS<sup>406</sup> AS A GUIDE TO INNOVATION

Nortel Networks Corporation (NNC) is a company incorporated in Canada. It controlled over 130 subsidiaries in over 60 countries.<sup>407</sup> It is the parent of Nortel Networks Inc. (NNI), a Delaware incorporated company controlling the operations of the entire group, and which is the direct subsidiary of Nortel Networks Limited (NNL), a Canadian incorporated entity that is a subsidiary of NNC.<sup>408</sup> Nortel Networks United Kingdom Limited (NNUK) owned a number of Nortel's European subsidiaries through a holding company, Nortel International Finance and Holding BV.<sup>409</sup>

Nortel's growth from its 1883 origins in Canada to a multinational conglomerate operating in the United States, Asia, Africa, Latin America, and Europe occurred from 1980 to 2000.<sup>410</sup> At its zenith, Nortel employed over 93,000 people and had a market capitalization in excess of \$250 billion.<sup>411</sup> However, following the bursting of the technology stock market bubble in 2000, the Nortel Group's fortunes changed.<sup>412</sup> It struggled to maintain its market position and suffered a severe loss of revenue. The market in which it operated changed rapidly with new technology and the company failed to adapt.<sup>413</sup> These difficulties were exacerbated when in 2004 it announced accounting irregularities and had to restate earnings for prior years.<sup>414</sup> In response to these accounting restatements, credit ratings agencies downgraded its credit to investment grade.<sup>415</sup> This had a cascading effect on the company's ability to access financing and triggered a liquidity crisis.<sup>416</sup> In 2009, Nortel's United States entities filed for Chapter 11 relief in

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405. *Id.* at 339.

406. *Re Nortel Networks Corp.*, 2015 CanLII 2987 (Can. Ont. Sup. Ct. J.).

407. *Id.* ¶ 14.

408. *Id.* ¶¶ 11, 15.

409. *See* Letter from C. Hill, Ernst & Young, to Nortel Networks Creditors 14 (Aug. 13, 2009), [http://www.emeanortel.com/collateral/reports/adminprogrpt\\_uk\\_en.pdf](http://www.emeanortel.com/collateral/reports/adminprogrpt_uk_en.pdf).

410. *Re Nortel Networks Corp.*, 2015 CanLII 2987 ¶ 12 (Can. Ont. Sup. Ct. J.).

411. Tom Hals, *U.S., Canadian Courts Begin Unusual Trial over Nortel Billions*, REUTERS (May 12, 2014), <http://www.reuters.com/article/2014/05/12/nortel-bankruptcy-trial-id-USL1N0NYOW520140512>.

412. *Re Nortel Networks Corporation*, 2015 CanLII 2987 ¶ 22 (Can. Ont. Sup. Ct. J.).

413. *See id.* ¶ 83.

414. *Id.* ¶ 22.

415. *Id.*

416. *Id.*

the United States, and the Canadian entities approached the court in Ontario for relief from their creditors under the Canadian Companies' Creditors Arrangement Act (CCAA).<sup>417</sup> Administration proceedings were commenced in the United Kingdom (UK) under the Insolvency Act 1986 and four members of Ernst & Young were appointed as joint administrators. Secondary insolvency proceedings were commenced in France at the request of the joint administrators and the French court appointed a separate liquidator.<sup>418</sup> The United States court recognized the United Kingdom proceedings as foreign main proceedings under Chapter 15 (the United States' enactment of the Model Law).<sup>419</sup>

In June 2009, the United States debtors, Canadian debtors, and some of the European debtors entered into an agreement called the Interim Funding Settlement Agreement (IFSA), which was then approved by the United States and Canadian courts.<sup>420</sup> Thereafter, a global liquidation of assets was commenced with \$9 billion realized from the sales.<sup>421</sup> The liquidation was successful because the parties did not dispute about allocation at this stage—recognizing the possibility of diminution in value from the transactions if the sale was contingent upon contested questions being determined.<sup>422</sup> Following this, a court-ordered mediation sought to determine a method for the distribution of these funds to the creditors.<sup>423</sup> When this failed, under the IFSA, a joint trial was held to determine how to allocate these funds.<sup>424</sup> The joint trial by courts in the United States and Canada required courts in Toronto and Wilmington to be connected by electronic means so that lawyers and witnesses could communicate in a secure manner.<sup>425</sup> The

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417. *Id.* ¶ 24.

418. *Id.*

419. Under § 1517(b), a foreign proceeding shall be recognized “(1) as a foreign main proceeding if it is pending in the country where the debtor has the center of its main interests.” 11 U.S.C. § 1517(b) (2012).

420. *Re Nortel Networks Corp.*, 2015 CanLII 2987 ¶ 30 (Can. Ont. Sup. Ct. J.).

421. *Id.* ¶¶ 3, 33.

422. *Id.* ¶ 4.

423. *In re Nortel Networks, Inc.*, Nos. 5307, 5531, slip op. at 4–5 (Bankr. D. Del. Apr. 3, 2013).

424. The IFSA provided in paragraph 8 that the “U.S. Court shall have sole and exclusive jurisdiction and power over the conduct of the U.S. Proceedings and the hearing and determination of matters arising in the U.S. Proceedings. The Canadian Court shall have sole and exclusive jurisdiction and power over the conduct of the Canadian Proceedings and the hearing and determination of matters arising in the Canadian Proceedings.” Cross-Border Insolvency Protocol, Exhibit B to Order Pursuant to 11 U.S.C. § 105(a) Approving Cross-Border Court-to-Court Protocol at 4, No. 09-10138 (D. Del. Jan. 15, 2009).

425. Paragraph 12(d) provided that “The U.S. Court and the Canadian Court may conduct joint hearings with respect to any cross-border matter or the interpretation or

judges communicated with each other and sought to issue consistent rulings.<sup>426</sup>

Nortel was so highly integrated that “[while] all corporate entities complied with local laws regarding corporate governance, no corporate entity carried on business on its own.”<sup>427</sup> The court was required to determine a method for the distribution of assets realized from the liquidation and the most contentious assets were the intellectual property rights.<sup>428</sup> The court held that “[i]t would unjustly enrich NNL to deprive all of the other RPEs of the work that they did in creating the IP just because the patents were registered in NNL’s name.”<sup>429</sup>

The court relied upon the doctrine of unjust enrichment and held that “NNL would be unjustly enriched by being entitled to all of the proceeds of the sale of Nortel IP at the expense of the other RPEs who contributed to the creation of that IP just because the patents were registered in NNL’s name. It would be inequitable.”<sup>430</sup>

The judge described the colossal insolvency proceeding in saying that:

This is an unprecedented case involving insolvencies of many corporations and bankrupt estates in different jurisdictions. . . . Nortel was organized along global product lines and global R&D projects pursuant to a horizontally integrated matrix structure and no one entity or region was able to provide the full line of Nortel products and services. . . . The fact that Nortel ensured that legal entities were properly created and advised in the various countries in which it operated in order to meet local legal requirements does not mean that Nortel operated a separate business in each country. It did not . . . Nortel’s matrix structure also allowed Nortel to draw on employees from different functional disciplines worldwide (e.g. Sales, R&D, operations, finance, general and administrative, etc.), regardless of region or country according to need.<sup>431</sup>

The court aimed to craft principles in largely uncharted waters—to make a determination about distribution between formally separate companies in a multinational enterprise structure. Eventually, it fell back on the principle of just allocation given the unique cir-

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implementation of this Protocol where both the U.S. Court and the Canadian Court consider such a joint hearing to be necessary or advisable.” *Id.* at 6.

426. *Re Nortel Networks Corp.*, 2015 CanLII 2987 ¶ 10 (Can. Ont. Sup. Ct. J.).

427. *Id.* ¶ 17.

428. *Id.* ¶ 46.

429. *Id.* ¶ 197.

430. *Id.* ¶ 200.

431. *Id.* ¶¶ 201–03.

cumstances in order to make a determination regarding allocation.<sup>432</sup> The court asserted that it has “wide powers in a CCAA proceeding to do what is just in the circumstances. Section 11(1) provides that a court may make any order it considers appropriate in the circumstances.”<sup>433</sup>

The judge in the case also relied upon a Supreme Court decision, which stated that “the CCAA is skeletal in nature and does not contain a comprehensive code that lays out all that is permitted . . . [that t]he incremental exercise of judicial discretion . . . [with respect to] the CCAA has been adapted and has evolved to meet contemporary business and social needs . . . [and that w]hen large companies encounter difficulty, [and] reorganizations become increasingly complex[,] CCAA courts have been called upon to innovate accordingly.”<sup>434</sup> In adopting this approach, the court was guided by the practical realities and transaction costs generated by Nortel’s collapse:

[The company’s] early success in maximizing the value of its global assets through cooperation has disintegrated into value-erosive adversarial and territorial litigation described by many as scorched earth litigation. The costs have well exceeded \$1 billion. A global solution in this unprecedented situation is required and perforce, as this situation has not been faced before, it will by its nature involve innovation. Our courts have such jurisdiction.<sup>435</sup>

After deciding that it had the capacity to innovate, the court turned to “a fundamental tenet of insolvency law,” which stipulates that “all debts shall be paid *pari passu* and all unsecured creditors receive equal treatment.”<sup>436</sup> It then applied a *pro rata* distribution overruling objections that such an allocation would result in effectively imposing a substantive consolidation.<sup>437</sup> The court rejected the idea of substantive consolidation, stating that each entity

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432. *Id.* ¶ 204.

433. *Id.* ¶ 205.

434. *Century Services Inc. v. Canada (Att’y Gen.)*, [2010] 3 S.C.R. 379, ¶¶ 57–58, 61 (Can.) (internal citations and quotations omitted).

435. *Re Nortel Networks Corp.*, 2015 CanLII 2987 ¶ 208 (Can. Ont. Sup. Ct. J.).

436. *Id.* ¶ 209.

437. As the court explained: “In a liquidation or reorganization of a corporate group, the doctrine of substantive consolidation has emerged in order to provide a mechanism whereby the court may treat the separate legal entities belonging to the corporate group as one. In particular, substantive consolidation allows for the combination of the assets and liabilities of two or more members of the group, extinguishes inter-company debt and creates a single fund from which all claims against the consolidated debtors are satisfied. In effect, under substantive consolidation, claims of creditors against separate debtors instantly become claims against a single entity.” *Id.* ¶ 213.

remained separate with its own creditors and its actions would not result in all the creditors having claims against just one entity.<sup>438</sup> Perhaps more crucially, the judge wrote that “[e]ven if it could be said that a pro rata allocation involved substantive consolidation, which it cannot, I do not see case law precluding it in the unique circumstances of this case [sic] international case. Even in domestic cases, CCAA plans involving substantive consolidation are not unknown.”<sup>439</sup>

The court recognized that under Canadian law, “neither the CCAA nor the BIA contains express provisions authorizing substantive consolidation.”<sup>440</sup> It noted that although the U.S. Bankruptcy Code does not specifically allow substantive consolidation, courts in the United States and Canada had utilized their equitable jurisdiction to make consolidation orders.<sup>441</sup> The court’s assessment was guided by ‘the clear and uncontested’ evidence that:

Nortel (a) had fully integrated and interdependent operations; (b) had intercompany guarantees for its primary indebtedness; (c) operated a consolidated treasury system in which generated cash was used throughout the Nortel Group as required; (d) disseminated consolidated financial information throughout its entire history, save for the year before its bankruptcy; and (e) created IP through integrated R&D activities that were global in scope.<sup>442</sup>

Thus, the Nortel case presents a current and tangible manifestation of the difficult legal issues presented by the insolvency of an enterprise group and the unsatisfactory state of the law in this area. The case also shows that the courts have recognized these difficulties and are prepared to innovate in order to find solutions. However, such ad hoc innovation by judges presents its own problems and introduces uncertainty and additional transaction costs for commercial actors. Nonetheless, until a binding convention is adopted, judicial innovation and pragmatism are the only possible solutions.

In contrast, UK cases such as *Rubin*<sup>443</sup>—albeit on a smaller scale and involving the enforcement of foreign insolvency judgments—illustrate the difficulties presented by courts’ refusal to innovate and accept commercial realities. In that case, Eurofinance estab-

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438. See *id.* ¶¶ 213–15.

439. *Id.* ¶ 215.

440. *Id.* ¶ 216.

441. *Id.*

442. *Id.* ¶ 223.

443. *Rubin v. Eurofinance S.A.* [2010] EWCA (Civ) 895 (Eng.).

lished an entity known as The Consumers Trust (TCT), which was part of a scam.<sup>444</sup> U.S. customers were given vouchers that promised a 100% rebate of the purchase price of various goods upon the meeting of certain conditions. These conditions were apparently impossible to satisfy and the scheme was built upon most consumers not satisfying them. TCT received a 15 percent payment from sellers of the vouchers and retained 40 percent of that amount to cover the possibility of the vouchers being redeemed.<sup>445</sup> This was a trivial amount and was unlikely to handle a situation where many customers presented vouchers for redemption. While this money was held in the United States, the rest was distributed to Eurofinance and others.

A state attorney general sued for breach of consumer protection legislation and TCT settled the action by paying \$1.65 million and \$200,000 in costs.<sup>446</sup> Thereafter, with the prospect of further suits by other states, TCT filed a petition under Chapter 11 in New York.<sup>447</sup>

Eurofinance and other respondents were hit with avoidance of transfers actions in order to avoid and recover payments made to them.<sup>448</sup> They did not submit to the jurisdiction of the New York court and did not participate in the case.<sup>449</sup> In 2008, judgments were entered against them, and the appellants sought both recognition of the Chapter 11 case in England, under the Cross-Border Insolvency Regulations of 2006, and enforcement of the judgments.<sup>450</sup> The lower court granted recognition but refused enforcement of the judgments against the respondents.<sup>451</sup> The High Court reversed the denial of enforcement by relying upon Lord Hoffmann's opinions in *Cambridge Gas* and *HIH*.<sup>452</sup>

On appeal, Lord Collins wrote the majority opinion for the UK Supreme Court. He affirmed that “[t]here is no international unanimity or significant harmonisation on the details of insolvency law.”<sup>453</sup>

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444. *See id.* ¶ 3.

445. *Id.* ¶ 5.

446. *Id.* ¶ 6.

447. *See id.* ¶ 7.

448. *See id.* ¶ 11.

449. *See id.*

450. *See id.* ¶¶ 11–14.

451. *See id.* ¶ 24.

452. *See id.* ¶ 62.

453. *Rubin v. Eurofinance S.A.* [2012] UKSC 46 [15], [533] (Eng.).

With regard to the enforcement of foreign insolvency judgments, Lord Collins wrote:

[T]he CBIR (and the Model Law) say nothing about the enforcement of foreign judgments against third parties. As Lord Mance pointed out in argument, recognition and enforcement are fundamental in international cases. Recognition and enforcement of judgments in civil and commercial matters (but not in insolvency matters) have been the subject of intense international negotiations at the Hague Conference on Private International Law, which ultimately failed because of inability to agree on recognised international bases of jurisdiction. . . . It would be surprising if the Model Law was intended to deal with judgments in insolvency matters by implication. Articles 21, 25 and 27 are concerned with procedural matters. No doubt they should be given a purposive interpretation and should be widely construed in the light of the objects of the Model Law, but there is nothing to suggest that they apply to the recognition and enforcement of foreign judgments against third parties.<sup>454</sup>

It is arguable that if enterprise law principles had been applied, the court would have been able to treat the entities as one unit. In such circumstances, it would have been possible to recognize and enforce the U.S. judgment by disregarding the separate entities specifically established to shield the actual commercial actors from liability for their wrongs. If a similar fact pattern were to arise in Australia, this Article submits that a court could employ the powers conferred by Article 21(g) of the Model Law to grant relief in accordance with provisions of the Corporations Act, and then utilize the powers to make a pooling order in the case of an enterprise group. While this solution requires judicial ingenuity, it would be consistent with cases discussed above and commercial expectations of the parties.

## VI. CONCLUSION

Multinational corporate groups do not belong to any one country—and if they do, they can change that affiliation almost at will. The problems associated with insolvency of multinational corporate groups pose serious threats to the efficiency of the insolvency process. Various attempts to address the issues have been stymied by an over-reliance on entity law to the exclusion of enterprise law. The natural territorialist tendencies of countries combined with the respect for the separate legal entity doctrine has created a hur-

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454. *Id.* ¶¶ 142–43.

dle for international lawmakers to address the cross-border insolvency of corporate enterprises.

Perhaps such a challenge requires a bold solution. It may be that a supranational insolvency court set up at the Hague, with power to resolve multinational corporate insolvencies, is the solution. In this solution, issues of COMI dissolve. Under the Model Law, if COMI can be established, proceedings commenced in the COMI are the main proceedings and receive the attendant remedies under the Model Law. To many creditors, such a court would be a foreign court. It should not matter to those creditors whether the proceedings are decided in that court or an independent world court. It matters little if the creditors claim is resolved in the Bankruptcy Court of the Southern District of New York or in the International Court at the Hague. A foreign court would eliminate forum shopping and would create a level playing field. Further, creditors would have certainty about where any insolvency would be resolved. All parties would be aware that, if the corporate group entered insolvency, its insolvency would be resolved in the international court under a single set of laws. This would be tantamount to a unity of proceedings—the Shangri-La of international insolvency academics. And it would create certainty in terms of the applicable procedures.

Such a solution also provides certainty *ex ante* for contractualists who argue that creditors should be able to agree *ex ante* on an insolvency solution. If an international court is used, the contractualists' work is done—as all creditors would be aware of the eventual court in the event of insolvency. It could apply a harmonized law and would be given power to substantively coordinate proceedings across national boundaries. Territorialist concerns related to the primacy of sovereign states should not be enlivened because corporate groups have no home country and no allegiance apart from which country will offer it the greatest economic benefit.<sup>455</sup>

At present, however, the prospects for an international insolvency court are slim. In the interim, the gap caused by the lack of a clear and certain legal regime, can be fixed by interpreting the provisions of the Model Law in line with its design architecture, which confers substantial discretion on courts. If courts exercise those powers to examine the truth behind the structuring of multinational enterprise groups, and look at the true nature of the actual functioning of these entities, some of the problems of such

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455. However, see LYNN M. LoPUCKI, *COURTING FAILURE: HOW COMPETITION FOR BIG CASES IS CORRUPTING THE BANKRUPTCY COURTS* 207–32 (2005).

catastrophic insolvencies can be mitigated. If such an examination reveals that the group has been functioning as one unity, it is perfectly apposite for the court to disregard the legal fiction that is the group structure and look at the multinational enterprise as a whole. This is particularly true when the companies maintain common accounts, research and development, develop and share intellectual property resources, and present a common face to the market. Nortel Networks provides the perfect example.

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