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Treatment of corporate groups in insolvency

Note by the Secretariat

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5. Avoidance

[Reference: Legislative Guide: part two, chap. II, paras. 148-203 and recommendations 87-99]

1. The recommendations of the UNCITRAL Legislative Guide on Insolvency Law[1] relating to avoidance would generally apply to avoidance of transactions in the context of a corporate group, although additional considerations may apply to transactions between members of the group. A significant expenditure of time and money may be required to disentangle the layers of intra-group transactions in order to determine which, if any, are subject to avoidance. Some transactions that might appear to be preferential or undervalued as between the immediate parties might be considered differently when viewed in the broader context of a closely integrated group, where the benefits and detriments of transactions might be more widely assigned. Similarly, some transactions occurring within a group that might be for legitimate purposes would not take place outside the group if the benefits and detriments were analysed on normal commercial grounds.

2. Intra-group transactions may represent trading between group members; channelling of profits upwards from the subsidiary to the parent; loans from one member to another to support continued trading by the borrowing member; asset transfers and guarantees between group members; payments by a company to a creditor of a related company; a guarantee or mortgage given by one group company to support a loan by an outside party to another group company; or a range of other transactions. A group may have the practice of putting all available money and assets in the group to the best commercial use in the interests of the group as a whole, as opposed to the benefit of the group member to which they belong. This might include sweeping cash from subsidiaries into the financing member of the group. Although this might not always be in the best interests of the subsidiary, some laws permit directors of wholly owned subsidiaries, for example, to act in that manner, provided it is in the best interests of the parent.

3. Some of the transactions occurring in the group context may be clearly identified as falling within the categories of transactions subject to avoidance under recommendation 87[2] of the Legislative Guide. Other transactions may not be so

[1] UNCITRAL Legislative Guide, recommendations 87-99.

[2] Recommendation 87 provides:

Avoidable transactions

87. The insolvency law should include provisions that apply retroactively and are designed to overturn transactions, involving the debtor or assets of the estate, and that have the effect of either reducing the value of the estate or upsetting the principle of equitable treatment of creditors. The insolvency law should specify the following types of transaction as avoidable:

(a) Transactions intended to defeat, delay or hinder the ability of creditors to collect claims where the effect of the transaction was to put assets beyond the reach of creditors or potential creditors or to otherwise prejudice the interests of creditors;

(b) Transactions where a transfer of an interest in property or the undertaking of an clearly within the scope of recommendation 87 and may raise issues concerning the extent to which the group was operated as a single enterprise or the assets and liabilities of group members were closely intermingled, thus potentially affecting the nature of the transactions between members and between members and external creditors. There may also be transactions that are not covered by the terms of avoidance provisions. Some insolvency laws, for example, may provide for avoidance of preferential payments to a debtor's own creditors, but not to the creditors of a related group member, unless the payment is made, for example, pursuant to a guarantee.

4. Transactions between members of a corporate group might be covered by those provisions of an insolvency law dealing with transactions between related persons. The Legislative Guide defines "related person" to include members of a corporate group such as a parent, subsidiary, partner or affiliate of the insolvent member of the group against which insolvency proceedings have commenced or a person, including a legal person, that is or has been in control of the debtor. Those transactions are often subject, under the insolvency law, to stricter avoidance rules than other transactions, in particular with regard to the length of suspect periods, as well as presumptions or shifted burdens of proof to facilitate avoidance proceedings[3] and dispensing with requirements that the debtor was insolvent at the time of the transaction or was rendered insolvent as a result of the transaction. A stricter regime may be justified on the basis that these parties are more likely to be favoured and tend to have the earliest knowledge of when the debtor is, in fact, in financial difficulty.

5. One approach to the burden of proof in the case of transactions with related persons might be to provide that the requisite intent or bad faith is deemed or presumed to exist where certain types of transaction are undertaken within the suspect period and the counterparty to the transaction will have the burden of proving otherwise. In the context of corporate groups, some laws have established a rebuttable presumption that transactions among corporate group members and between those members and the shareholders of that corporate group would be detrimental to creditors and therefore subject to avoidance. Additionally, the claims of the related group member may be subjected to special treatment and the rights of related group members under intra-group debt arrangements deferred or subordinated to the rights of external creditors of the insolvent members (on subordination, see below).

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obligation by the debtor was a gift or was made in exchange for a nominal or less than equivalent value or for inadequate value that occurred at a time when the debtor was insolvent or as a result of which the debtor became insolvent (undervalued transactions); and

(c) Transactions involving creditors where a creditor obtained, or received the benefit of, more than its pro rata share of the debtor's assets that occurred at a time when the debtor was insolvent (preferential transactions).

[3] See Legislative Guide, recommendation 97, which provides:

97. The insolvency law should specify the elements to be proved in order to avoid a particular transaction, the party responsible for proving those elements and specific defences to avoidance. Those defences may include that the transaction was entered into in the ordinary course of business prior to commencement of insolvency proceedings. The law may also establish presumptions and permit shifts in the burden of proof to facilitate the conduct of avoidance proceedings.

6. With respect to the commencement of avoidance actions, the level of integration of the group may also have the potential to significantly affect the ability of creditors to identify the group member with which they dealt where the insolvency law permits them to commence avoidance proceedings.

Recommendations

Avoidance

(20) The insolvency law should specify that, in considering whether a transaction of the kind referred to in recommendation 87 (a), (b) or (c) of the Legislative Guide that took place between related persons in a corporate group context should be avoided, the court may have regard to the circumstances of the group in which the transaction took place. Those circumstances may include: the degree of integration between the members of the corporate group that are party to the transaction; the purpose of the transaction; and whether the transaction granted advantages to members of the group that would not normally be granted between unrelated parties.

(21) The insolvency law may specify that, with respect to the elements referred to in recommendation 97 of the Legislative Guide and their application in the context of a corporate group, special provisions concerning defences and presumptions apply.

Notes on recommendations

7. Recommendation (20) takes note of the fact that transactions occurring within a corporate group raise considerations additional to those generally applying to transactions between related parties. While the provisions of the Legislative Guide would generally apply, the Working Group may wish to consider whether those additional considerations should be reflected in recommendations.

8. At its thirty-first session, the Working Group noted that broad application of rebuttable presumptions concerning transactions between corporate group members and between those members and the shareholders of that group could be detrimental to creditors and should be avoided.[4] Recommendation (21) notes the need for special consideration to be given to the application of burden of proof provisions and the use of presumptions in the corporate group context, without specifying the detail.

6. Subordination

[Reference: Legislative Guide: part two, chap. V, paras. 55-61]

9. The Legislative Guide notes[5] that subordination refers to a rearranging of creditor priorities in insolvency and does not relate to the validity or legality of the claim. Notwithstanding the validity of a claim, it might nevertheless be subordinated because of a voluntary agreement or a court order. Two types of claims that typically may be subordinated in insolvency are those of persons related to the debtor and of owners and equity holders of the debtor.

[4] Report of Working Group V (Insolvency Law) on the work of its thirty-first session, A/CN.9/618, para. 44.

[5] UNCITRAL Legislative Guide, part two, chap. V, para. 56.

(a) Related person claims

10. In the corporate group context, subordination of related person claims might mean, for example, that the rights of group members under intra-group arrangements could be deferred to the rights of external creditors of those group members subject to insolvency proceedings.

11. As noted above, the term "related person" as used in the Legislative Guide would include members of a corporate group. The mere fact of a special relationship with the debtor, including, in the corporate group context, being another member of the same group, may not be sufficient in all cases to justify special treatment of a creditor's claim. In some cases these claims will be entirely transparent and should be treated in the same manner as similar claims made by creditors who are not related persons; in other cases they may give rise to suspicion and will deserve special attention. An insolvency law may need to include a mechanism to identify those types of conduct or situation in which claims will deserve additional attention. Similar considerations apply, as noted above, with respect to avoidance of transaction occurring between members of a corporate group.

12. The Legislative Guide identifies a number of situations in which special treatment of a related person's claim might be justified (e.g. where the debtor is severely undercapitalized and where there is evidence of self-dealing). In the group context, additional considerations might include, as between a parent and a controlled subsidiary, the parent's participation in the management of the subsidiary; whether the parent has sought to manipulate intra-group transactions to its own advantage at the expense of external creditors; or whether the parent has otherwise behaved unfairly, to the detriment of creditors and shareholders of the controlled group member. Under some laws, the existence of those circumstances might result in the parent having its claims subordinated to those of unrelated unsecured creditors or even minority shareholders of the controlled company.

13. Some laws include other approaches to intra-group transactions such as permitting debts owed by a group member that borrowed funds under an intra-group lending arrangement to be involuntarily subordinated to the rights of external creditors of that borrowing member, permitting the court to review intra-group financial arrangements to determine whether particular funds given to a group member should be treated as an equity contribution rather than as a loan, where equity contributions are subordinated to creditor claims (on treatment of equity, see below); and allowing voluntary subordination of intra-group claims to those of external creditors.

14. The practical result of a subordination order in a corporate group context might be to reduce or effectively extinguish any repayment to those group members whose claims have been subordinated if the claims of secured and unsecured external creditors are large in relation to the funds available for distribution. In some cases this might threaten the viability of the subordinated group member and be detrimental not only to its own creditors, but also its shareholders.

(b) Treatment of equity

15. The Legislative Guide notes[6] that many insolvency laws distinguish between the claims of owners and equity holders that may arise from loans extended to the debtor or their ownership interest in the debtor. With respect to claims arising from equity interests, many insolvency laws adopt the general rule that the owners and equity holders of the business are not entitled to a distribution of the proceeds of assets until all other claims that are senior in priority have been fully repaid (including claims of interest accruing after commencement). As such, these parties will rarely receive any distribution in respect of their interest in the debtor. Where a distribution is made, it would generally be made in accordance with the ranking of shares specified in the company law and the corporate charter. Debt claims, such as those relating to loans, however, are not always subordinated.

16. Few insolvency laws specifically address subordination of equity claims in the corporate group context. One that does allows the courts to review intra-group financial arrangements to determine whether particular funds given to a group member that is now subject to insolvency proceedings should be treated as an equity contribution, rather than as an intra-group loan, enabling it to be postponed behind creditors' claims. Those funds are likely to be treated as equity where the original debt to equity ratio was high before the funds were contributed and the funds would reduce the ratio; if the paid-up share capital was inadequate; if it is unlikely that an external creditor would have made a loan in the same circumstances; and if the terms on which the advance was made were not reasonable and there was no reasonable expectation of repayment.

17. The Working Group may wish to consider the need for recommendations dealing with subordination in the context of a corporate group and the circumstances in which subordination might be appropriate.

C. Remedies

1. Introduction

18. Because of the nature of corporate groups and the way in which they operate, there may be, as noted above, a complex web of financial transactions between members of the group, and creditors may have dealt with different members or even with the group as a single economic entity, rather than with individual members. Disentangling the ownership of assets and liabilities and identifying the creditors of each member of the group may involve a complex and costly legal inquiry. However, because adherence to the separate entity approach means that creditors of each group member must in general look to that group member for payment of their debt, it will generally become necessary, where insolvency proceedings have commenced against one or more of the members of that group, to disentangle the ownership of their assets and liabilities.

19. Where this disentangling can be effected, adherence to the separate entity principle operates to limit creditor recovery to the assets of the insolvent group member. Where it cannot be effected or other specified reasons exist to treat the

[6] UNCITRAL Legislative Guide, part two, chap. V, para. 76.

group as a single enterprise, some laws include remedies that allow the single entity approach to be set aside. Historically, these remedies have been developed to overcome the perceived inefficiency and unfairness of the traditional separate entity approach in specific cases. In addition to setting aside intra-group transactions or subordinating intra-group lending, the remedies include: extending liability for external debts to other solvent members of the group, as well as to office holders and shareholders; contribution orders; and pooling or (substantive) consolidation orders. Some of these remedies require findings of fault to be made, while others rely upon the establishment of certain facts with respect to the operations of the corporate group. In some cases, particularly where misfeasance of management is involved, other remedies might be more appropriate, such as removal of the offending directors and limiting management participation in reorganization.

20. Because of the potential inequity that may result when one creditor group is forced to share assets and liabilities with other creditors of another group member that may be less solvent, these remedies are not universally available, generally not comprehensive and apply only in restricted circumstances. Those remedies involving extension of liability may involve “piercing” or “lifting the corporate veil”, by which shareholders, who are generally shielded from liability for the corporation’s activities, can be held liable for certain activities. The other remedies discussed here do not, although in some circumstances the effect may appear to be similar.

2. Contribution orders

21. A contribution order is an order by which a court can require a solvent member of a corporate group to contribute specific funds to cover all or some of the debts of other group members in liquidation. Although contribution orders are not widely available under insolvency laws, a few jurisdictions have adopted or are considering adopting these measures. Under those laws that do permit contribution orders, the problem, as noted above, of reconciling the interests of the two sets of unsecured creditors that have dealt with the two separate group companies, has meant that the power to make a contribution order is not commonly exercised. Courts have also taken the view that a full contribution order may be inappropriate if the effect is to threaten the solvency of the related company not already in liquidation, although it might be possible to order a partial contribution that is limited to certain assets, such as the balance remaining after meeting bona fide obligations.

22. Under one law that does provide for contribution orders, the court must take into account certain specified circumstances in considering whether to make an order. These include: the extent to which a related company took part in the management of the company in liquidation; the conduct of the related company towards the creditors of the company in liquidation, although creditor reliance on the existence of a relationship between the companies is not sufficient grounds for making an order; the extent to which the circumstances giving rise to liquidation are attributable to the actions of the related company; the conduct of the solvent company after commencement of the liquidation of its related company, particularly if it indirectly or directly affects the creditors of the related company, such as with

respect to failure to perform a contract; and such other matters as the court thinks fit.[7]

3. Substantive consolidation or pooling

(a) Introduction

23. Another remedy is substantive consolidation or pooling (referred to as consolidation). As noted above, where joint administration occurs, the assets and liabilities of the debtors remain separate and distinct, with the substantive rights of claimants unaffected. Consolidation, however, permits the court, in insolvency proceedings involving two or more members of the same corporate group, 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. This has the effect of creating a single estate for the general benefit of all creditors of all consolidated group members. Consolidation would generally involve the group members against which insolvency proceedings had commenced, but in some cases might extend to a solvent group member, where the affairs of that member were so closely intermingled with those of other group members that it would be beneficial to include it in the consolidation. It may even extend to individuals, such as the controlling shareholder. While typically requiring a court order, consolidation may also be possible on the basis of consensus of the relevant interested parties or by way of an approved reorganization plan.

24. Few jurisdictions provide statutory authority for consolidation orders,[8] and where the remedy is available, in general it is not widely used. Notwithstanding the absence of direct statutory authority or a prescribed standard for the circumstances in which such orders can be made, the courts of some jurisdictions have played a direct role in developing these orders and delimiting the appropriate circumstances. This practice reflects increased judicial recognition of the widespread use of interrelated corporate structures for taxation and business purposes. As is the case with contribution orders, the circumstances that would support a consolidation order are very limited and tend to be those where because of a high degree of integration of the members of a corporate group, whether through control or ownership, it would be difficult, if not impossible, to disentangle the assets and liabilities of the different group members and administer the estate of each debtor separately.

25. Consolidation is typically discussed in the context of liquidation and the legislation that does authorize such orders does so only in that context. There are, however, legislative proposals that would permit consolidation in the context of various types of reorganization. In jurisdictions without specific legislation, consolidation orders may be available in both liquidation and reorganization, where such an order would, for example, assist the reorganization of the group.

26. Consolidation might be appropriate where it leads to greater return of value for creditors, either because of the structural relationship between the members of the group and the manner in which they conduct their business and financial relationships or because of the value of assets common to the whole group, such as intellectual property in both a process conducted across numerous group members

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7 New Zealand Companies Act 1993, Sections 271 (1)(a) and 272 (1).

8 Ibid, s272.

and the product of that process. A further situation might be where there is no real separation between the members of a group, the group structure being maintained solely for dishonest or fraudulent purposes. Since intra-group trading is increasingly a norm of commercial activity, consolidation could enable an insolvency representative to focus on the external debts of the group where intra-group debts disappeared as a result of consolidation (discussed further below).

27. The principal concerns with the availability of such orders, in addition to those associated with the fundamental issue of overturning the separate entity principle, include, as already noted, the potential unfairness caused to one creditor group when forced to share *pari passu* with creditors of another group member that may be less solvent and whether the savings or benefits to the collective class of creditors outweighs incidental detriment to individual creditors. Creditors opposing consolidation could argue that as they relied on the separate assets of a particular group member when trading with it, they should not be denied a full payout because of their trading partner's relationship with another member of the same group. Creditors supporting consolidation could argue that they had relied upon the assets of the whole group and that it would be unfair if they were limited to recovery against the assets of a single group member.

28. Because it involves pooling the assets of different group members, consolidation may not lead to increased recovery for all creditors, but rather operate to level the recoveries across all creditors, increasing the amount distributed to some at the expense of distributions to others. Additionally, the availability of consolidation may enable stronger, larger creditors to take advantage of assets that do not and should not properly be available to them; encourage creditors who disagree with such an order to seek review of the order, thus prolonging the insolvency proceedings; and damage the certainty and foreseeability of security interests (where intra-group claims disappear as a result of consolidation, creditors that have security interests in those claims will lose their rights).

(b) Circumstances supporting consolidation

29. A number of elements have been identified as relevant to determining whether or not substantive consolidation is warranted, both in the legislation that authorizes consolidation orders and where the courts have played a role in developing these orders. In each case it is a question of balancing the various elements; no single element is necessarily conclusive and all of the elements do not need to be present in any given case. The elements include: the presence or absence of consolidated financial statements for the group; the use of a single bank account for all group members; the unity of interests and ownership between the group members; the degree of difficulty in segregating individual assets and liabilities; sharing of overhead, management, accounting and other related expenses among different group members; the existence of intra-group loans and cross-guarantees on loans; the extent to which assets were transferred or funds shifted from one member to another as a matter of convenience without observing proper formalities; adequacy of capital; commingling of assets or business operations; appointment of common directors or officers and the holding of combined board meetings; a common business location; fraudulent dealings with creditors; the practice of encouraging creditors to treat the corporate group as a single entity, creating confusion among creditors as to which of the group members they were dealing with and otherwise

blurring the legal boundaries of the group companies; and whether consolidation would facilitate a reorganization or is in the interests of creditors. A further factor supporting consolidation might be where the only way to determine the status of various intra-group debts, if a consolidation order were not made, would be through separate legal proceedings. Such proceedings would invariably increase the cost and length of the liquidation and deplete the funds otherwise available for creditors.

30. While these many factors remain relevant, some courts have started to focus on two factors in particular, namely, whether creditors dealt with the group as a single economic unit and did not rely on the separate identity of individual group members in extending credit, and whether the affairs of the group members are so intermingled that consolidation will benefit all creditors.

(c) Competing interests in consolidation

31. In addition to the competing interests of the creditors of different members of a corporate group, the competing interests of different types of creditor warrant consideration in the context of consolidation: of creditors and shareholders; of shareholders of the different group companies, and in particular those who are shareholders of some of the companies but not of others; and of secured and priority creditors of different members of a consolidated group.

(i) Owners and equity holders

32. Many insolvency laws adopt the general rule that the rights of creditors outweigh those of owners and equity holders, with owners and equity holders being ranked after all other claims in the order of priority for distribution. Typically, this results in owners and equity holders not receiving a distribution.[9] In the corporate group context, the shareholders of some group members with many assets and few liabilities may receive a return when the creditors of other group members with fewer assets and more liabilities may not. If the general approach of ranking shareholders behind unsecured creditors were to be extended, in consolidation, to the group as a whole, all creditors could be paid before the shareholders of any group member received a distribution.

(ii) Secured creditors

33. With respect to secured creditors, both internal and external to the group, there is a question of how their rights should be treated in a consolidation. The Legislative Guide on Insolvency Law[10] discusses the position of secured creditors in insolvency proceedings and adopts the approach that while as a general principle the effectiveness and priority of a security interest should be recognized and the economic value of the encumbered assets should be preserved in insolvency proceedings, an insolvency law may nevertheless modify the rights of secured creditors in order to implement business and economic policies, subject to appropriate safeguards.

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[9] UNCITRAL Legislative Guide, part two, chap. V, para. 76.

[10] Annex I of the UNCITRAL Legislative Guide sets forth the sections of the Guide addressing the treatment of secured creditors in insolvency proceedings.

34. Questions that might arise with respect to consolidation might include: whether a security interest over some or all of the assets of one group member could extend to include assets of another group member where a consolidation order was made or whether that security interest should be limited to the defined pool of assets upon which the secured creditor had originally relied; whether secured creditors with insufficient security could claim the remaining debt against the pooled assets as unsecured creditors; and whether internal secured creditors (i.e. creditors that are other members of the same group) should be treated differently to external secured creditors. One solution with respect to external secured creditors might be to exclude them from the process of consolidation, thus achieving what might be a partial consolidation. Individual secured creditors that relied upon the separate identity of group members, such as where they relied upon an intra-group guarantee, might require special consideration. Where encumbered assets are required for reorganization, a different solution might be possible, such as allowing the court to adjust the consolidation order to make specific provision for such assets. The interests of internal secured creditors also need to be considered; different approaches might include cancelling internal security interests, leaving the creditors with an unsecured claim, or modifying or subordinating those interests.

(iii) Priority creditors

35. Similar questions arise with respect to the treatment of priority creditors. Practically, they might benefit or lose from the pooling of the group's assets in the same way as other unsecured creditors. Where priorities, such as those for employee benefits or tax, are based on the single entity principle, a question arises as to how they should be treated across the group, especially where they interact with each other. For example, employees of a group member that has many assets and few liabilities will potentially compete with those of a group member in the opposite situation, with few assets and many liabilities if there is consolidation. While priority creditors generally might obtain a better result at the expense of unsecured creditors without priority, the different groups of those priority creditors might have to adjust any expectations that are based on the single entity principle.

(d) Inclusion of solvent group members in consolidation

36. As noted above, consolidation might be extended to include solvent members of a corporate group, either because that group member is covered by the insolvency proceedings or because the affairs of that member are so closely intermingled with those of other group members that it would be beneficial to include it in the consolidation. Where that occurs, the creditors of that solvent group member may have particular concerns and a limited approach might be taken so that the consolidation order extended only to the net equity of the solvent group member in order to protect the rights of those creditors.

(e) Notification of creditors

37. The potential impact of consolidation on creditor rights suggests that affected creditors should have the right to be notified of any application for consolidation and the right to object. The interests of individual creditors who may have relied upon the separate identity of each group member in their dealings with a group would have to be weighed against the overall benefit to be gained by consolidation.

One issue to be considered is whether a single objection would be sufficient to prevent consolidation or whether consolidation could nevertheless be ordered. It may be possible, for example, to provide objecting creditors who will be significantly disadvantaged by the consolidation relative to other creditors with a substantially greater level of return than other unsecured creditors, thus departing from the strict policy of equal distribution. It may also be possible to exclude specific groups of creditors with certain types of contracts, for example limited recourse project financing arrangements entered into with clearly identified group members at arm's length commercial terms.

(f) Other issues: timing and inclusion of additional group members over time

38. Additional issues to be considered with respect to consolidation orders include the timing of such an order (whether it could only be made at an early stage of the proceedings or later when it emerged that to do so would enhance the value to be distributed to creditors) and whether an additional group member could be added to an existing consolidation. If the consolidation order is made with the consent of the creditors, or if creditors are given the opportunity to object to a proposed order, the addition of another group member at a later stage of the proceedings has the potential to vary the pool of assets from what was originally agreed or notified to creditors. In that situation, it is desirable that creditors have a further opportunity to consent or object to the addition to the consolidation.

Recommendations

Consolidation

(21) The insolvency law may permit the court to order insolvency proceedings against two or more members of a corporate group to proceed together as if they were a single entity in appropriate circumstances. In deciding whether appropriate circumstances exist, the court may consider:

(a) The extent to which there was such an intermingling of assets between the group members that it was impossible to disentangle the ownership of individual assets;

(b) The extent to which creditors had dealt with the members of a corporate group as a single economic unit and did not rely upon their separate identity in extending credit;

(c) The extent to which consolidation would benefit all creditors; and

(d) […].

Notes on recommendations

39. At its thirty-first session, the Working Group agreed that consolidation might be appropriate in certain limited circumstances and that judges would need clear criteria against which to assess the relevant issues.[11] Recommendation (21) recognizes that a court may order consolidation in appropriate circumstances and indicates some of the criteria that might be relevant to determining whether those

[11] Report of Working Group V (Insolvency Law) on the work of its thirty-first session, A/CN.9/618, paras. 37 and 42.

circumstances exist in a particular case. A number of additional examples of potentially appropriate circumstances are outlined in paragraph 29 above.

D. Reorganization

[Reference: Legislative Guide, Part two, chap. IV and recommendations 139-159]

40. The Legislative Guide includes a detailed treatment of issues relevant to reorganization and the negotiation, approval and implementation of a reorganization plan.[12] Many of the issues discussed and the recommendations will apply to the reorganization or two of more members of a corporate group. One issue not considered is whether a single reorganization plan can be proposed for two or more members of a group.

41. Where reorganization proceedings are commenced against two or more members of a group, irrespective of whether or not those proceedings can be jointly administered, there is a question of whether it will be possible to reorganize the debtors through a single reorganization plan that has the potential to deliver savings across the group's insolvency proceedings, ensure a coordinated approach to the resolution of the group's financial difficulties, and maximise value for creditors. Several insolvency laws permit the negotiation of a single reorganization plan. Under some laws this approach is only possible where the proceedings are jointly administered or consolidated. Where that is not permitted, a unified reorganization plan would generally only be possible where the proceedings could, as a matter of practice, be coordinated.

42. If the insolvency law were to permit a unified reorganization plan, consideration would need to be given to the application of a number of the provisions of the Legislative Guide relating to reorganization of a single debtor to the case of a corporate group. Relevant provisions might include those relating to: parties competent to propose the plan or participate in its proposal;[13] nature and content of a plan;[14] safeguards concerning a plan;[15] convening and conduct of creditors meetings in respect of a plan; classification of claims and classes of creditors;[16] voting of creditors and approval of a plan;[17] objections to approval of the plan (or confirmation where it is required);[18] and implementation of a plan.[19]

43. A single reorganization plan would need to take into account the different interests of the different groups of creditors, including the possibility that it might need to provide varying rates of return for the creditors of different group members. An appropriate balance between the rights of those different groups of creditors with respect to approval of the plan, including appropriate majorities, both within the creditors of a single group member and between creditors of different group members would also need to be achieved. For example, would rejection by the

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[12] UNCITRAL Legislative Guide, part two, chap. IV.
[13] Ibid, paras. 8-14.
[14] Ibid, paras. 3-5 and 17-25.
[15] Ibid, paras. 54-63.
[16] Ibid, paras. 27, 36-37, 41-43.
[17] Ibid, paras. 27-51.
[18] Ibid, paras. 53-63.
[19] Ibid, paras. 69-71.

creditors of one of several group members mean the plan could not go ahead? One approach might be based upon provisions applicable to the approval of a reorganization plan for a single debtor. Another approach might be to devise different majority requirements that are specifically designed to facilitate approval in the group context. Safeguards analogous to those in recommendation 152 of the Legislative Guide could also be included, with an additional requirement that the plan should be fair as between the creditors of different group members.

44. Recommendation 152 of the Legislative Guide provides:

Confirmation of an approved plan

152. Where the insolvency law requires court confirmation of an approved plan, the insolvency law should require the court to confirm the plan if the following conditions are satisfied:

(a) The requisite approvals have been obtained and the approval process was properly conducted;

(b) Creditors will receive at least as much under the plan as they would have received in liquidation, unless they have specifically agreed to receive lesser treatment;

(c) The plan does not contain provisions contrary to law;

(d) Administrative claims and expenses will be paid in full, except to the extent that the holder of the claim or expense agrees to different treatment; and

(e) Except to the extent that affected classes of creditors have agreed otherwise, if a class of creditors has voted against the plan, that class shall receive under the plan full recognition of its ranking under the insolvency law and the distribution to that class under the plan should conform to that ranking.

45. An insolvency law might also include provisions addressing the consequences of failure to approve such a reorganization plan as addressed by recommendation 158, especially where solvent members of a corporate group can be included in the plan. One law, for example, provides that the consequence of failure to approve a plan is the liquidation of all insolvent members of the group.

46. Recommendation 158 of the Legislative Guide provides:

Conversion to liquidation

158. The insolvency law should provide that the court may convert reorganization proceedings to liquidation where:

(a) A plan is not proposed within any time limit specified by the law and the court does not grant an extension of time;

(b) A proposed plan is not approved;

(c) An approved plan is not confirmed (where the insolvency law requires confirmation);

(d) An approved or a confirmed plan is successfully challenged; or

(e) There is substantial breach by the debtor of the terms of the plan or an inability to implement the plan.

Recommendations

Unified reorganization plan

(22) The insolvency law may permit the proposal of a unified reorganization plan for two or more members of a corporate group that are subject to insolvency proceedings.

(23) The insolvency lay may provide that a solvent member of the corporate group that is not subject to the insolvency proceedings can be included in a unified reorganization plan where the court determines that inclusion to be in the interests of the corporate group.

Notes on recommendations

47. Recommendations (22) and (23) outline the basic principles that an insolvency law may permit the proposal of a unified reorganization plan covering two or more members of a group against which insolvency proceedings have commenced and that a solvent member of the group not included in those insolvency proceedings may nevertheless be included in the plan where to do so would be in the interests of the group.

48. Taking into consideration the discussion included in paragraphs 42-44 above, the Working Group may wish to consider including additional recommendations addressing issues of content, in particular the extent to which it might be possible or necessary to allow different rates of return to be provided for different groups of creditors; approval; protections; failure of implementation; and other issues included in recommendations 139-159 of the Legislative Guide.

E. Other issues

49. In addition to the issues included above, the Working Group may wish to consider the following questions that have not yet been discussed:

(a) The application of recommendations 69-86 of the Legislative Guide, which address the treatment of contracts, in the case of insolvency of two or more members of a corporate group, particularly where those contracts were entered into between group members;

(b) Particular considerations that would apply to creditor participation in insolvency proceedings in a corporate group context where one or more of the creditors might be members of the same group and may or may not be subject to the same insolvency proceeding;

(c) The possibility of establishing a single creditor committee for each member of the group or each type of creditor across a group;

(d) With respect to creditor representation, special considerations that might apply to the application of recommendations 126-136 of the Legislative Guide, which address creditor participation. Members of a group that are creditors of other members of the group presumably would be considered to be related parties for the purpose of 131 and therefore disqualified from participating in creditor committees;

(e) The application of recommendations 137-138 of the Legislative Guide, which address rights of parties in interest to be heard and to appeal, to a member of a corporate group: "party in interest" as explained in the Legislative Guide would include a member of a corporate group in various possible ways, whether as a fellow debtor in joint proceedings, as a creditor, an equity holder, or simply as another member of the same group;

(f) Special considerations that might apply to submission of claims by other members of the same group, such as special scrutiny as claims by related persons under recommendation 184 of the Legislative Guide.

[*IV. International Issues is contained in A/CN.9/WP.76/Add.2*]