

Corporate Groups and Cross-Border Bankruptcy

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I. INTRODUCTION

The concept of the corporate group looms over commercial practice. On the one hand, it creates positive opportunities for ingenious and innovative expansion, but on the other, it often serves as a deeply complicating phenomenon in the legal resolution of commercial problems, ranging from the simplest to the most intricate. Generally speaking, “corporate group” is not a legal concept—one notable exception is the German *Konzernrecht*¹—but it is used extensively among practitioners. We are clearly talking about a group whose members consist of individual corporations and whose business activities are interlinked.

The logical conclusion that one corporation might be a shareholder in another corporation was well understood by the nineteenth century, and, while this was initially viewed with some suspicion,² it has now been exploited to the full in major

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1. See generally Karl Hofstetter, *Parent Responsibility for Subsidiary Corporations: Evaluating European Trends*, 39 INT’L & COMP. L.Q. 576, 579–82 (1990) (providing an overview of Germany’s corporate group legislation).

2. In the United States, it was not until New Jersey enacted its first general incorporation statutes in 1888–1893 that corporations were permitted to own shares in other corporations. PHILLIP I. BLUMBERG, *THE LAW OF CORPORATE GROUPS: PROBLEMS IN THE BANKRUPTCY OR REORGANIZATION OF PARENT*

industrial countries.³ There are several ways in which two or more corporations can be associated through corporate mechanisms. The simplest model, where one corporation, A, owns shares in another, B, is described sometimes as a vertical association between corporations.

The vertical association described above might be extended where, for example, B owns shares in C and so on. A horizontal association may exist where corporations A and B each own shares in the other. This too might be extended where A and/or B own shares in C, which in turn owns shares in A and/or B. In addition to share ownership, an association of companies might be established through the mechanism of corporate director appointment: corporation A might be given powers by the constitution of corporation B to appoint one or more directors to the board of B and vice versa.

Associations of corporations may also be established by other non corporate mechanisms. The most obvious is by contract, although this is rarely the method by which the close relationship contemplated in this article is achieved. In contrast, when corporations A and B have the same or largely the same shareholders and directors, they are likely to create a close association.⁴ For insolvency lawyers, an important consideration lies, in the event of the insolvency of one or more of the corporations that are associated, whether the assets and liabilities of the companies may be pooled in the carrying out of the insolvency process.

One further preliminary issue should be mentioned. While it is most often the case that the members of the group are corporations in the legal sense—registered under statute and enjoying the status of separate legal personality—sometimes a member of the group is not a corporation. The term “firm” is sometimes used, often deliberately to obliterate the distinction between incorporated and unincorporated business entities. To lawyers, this distinction is often of considerable importance, but in the world of business practice or to other groups of professionals or scholars, like economists, this distinction may be of little significance.⁵ And increasingly in the world of bankruptcy scholarship and practice, this problem has been finessed in the bankruptcy systems of many countries by giving significance to the distinction between commercial and consumer debtors and minimizing the distinction between incorporated and unincorporated debtors. Even in the U.K., where the sanctity of the incorporated/unincorporated divide is of the highest order, the bankruptcy

AND SUBSIDIARY CORPORATIONS, INCLUDING THE LAW OF CORPORATE GUARANTIES 4 (1985). In the U.K., this power depended on clear enunciation to this effect in the corporation's objects clause.

3. See, e.g., Daniel D. Prentice, *Some Aspects of the Law Relating to Corporate Groups in the United Kingdom*, 13 CONN. J. INT'L L. 305, 306 (1999) (discussing the “carrying on of business in group form” with respect to the U.K.); BLUMBERG, *supra* note 2, at xxxiv (discussing the “corporate group which collectively conducts the business of the enterprise” with respect to the United States); Ian M. Ramsay, *Allocating Liability in Corporate Groups: An Australian Perspective*, 13 CONN. J. INT'L L. 329, 332–34 (1999) (discussing corporate groups and the “entities which they control” with respect to Australia); see generally JANET DINE, *THE GOVERNANCE OF CORPORATE GROUPS* 41 (2000) (discussing multinational and transnational groups).

4. See generally, e.g., *Creasey v. Breachwood Motors*, [1992] B.C.C. 638 (Q.B.) (Eng.) (piercing the corporate veil because of shareholder/director overlap and evidence that the creation of the second corporation was intended to avoid liability by the first).

5. For a fascinating exploration, see HAROLD JOSEPH LASKI, *The Personality of Associations*, [1915–16] 29 H.L.R. 404, reprinted in *THE FOUNDATIONS OF SOVEREIGNTY AND OTHER ESSAYS* 139 (1921).

system is undermining that distinction by conferring on individuals and partnerships rescue regimes originally developed only for incorporated companies.⁶

In addition to the generic term of “firm,” the European Union has shown a tendency to legislate for “undertakings,”⁷ further blurring the distinction between incorporated and unincorporated organizations. Also, the recently enacted EC Regulation on Insolvency Proceedings not only applies to “whether the debtor is a natural person or a legal person, a trader or an individual,”⁸ but also provides the basis for secondary liquidation proceedings to take place where the debtor has an “establishment,” which is defined as “any place of operations where the debtor carries out a non-transitory economic activity with human means and goods.”⁹

Thus, in our consideration of the concept of the corporate group, we should be aware of the possibility that one or more entities within the group may be of unincorporated status. Ironically, we may well find in the decades to come that it is the enterprise groups consisting of incorporated associations that threaten the effectiveness of the EC Regulation—due to the inability of courts to break free from the dogma of the separate legal existence of each corporation, however much it might be under the control of another corporation or corporations in the same group. I will return to this point.

Instead of a reference to corporations, it may be more accurate to speak about enterprises—a wider term encompassing incorporated and unincorporated organizations and enjoying some real legal recognition, e.g., in the European Union constitution and in some of its primary legislation.¹⁰ Indeed, enterprise law is probably the best translation for the German legal term *Konzernrecht*. Also, UNCITRAL has adopted the term “enterprise group” in the deliberations of its Working Group, which is currently trying to bring some harmony among member states in handling the national and international problems that arise when one, some, or all of the members of an enterprise group suffers bankruptcy.¹¹

Our interest centers on those groups where the association among the different enterprises is strong and close. There have been various legislative attempts to define when an association among business entities constitutes a corporate group, but such legislative provisions tend to be restricted to carefully defined circumstances and to associations of corporate entities.¹² For our purposes, it is sufficient to adopt the UNCITRAL formula: the term enterprise group should be explained as “two or more enterprises that are interconnected by ownership or control.”¹³

6. See generally The Insolvent Partnerships Order, 1994, S.I. 2421 (U.K.) (extending insolvency procedures promulgated for companies to partnerships).

7. See, e.g., Consolidated Version of the Treaty on European Union and of the Treaty Establishing the European Community, Dec. 29, 2006, 2006 O.J. (C 321) 1, arts. 81–86 (establishing “Rules Applying to Undertakings”).

8. Council Regulation on Insolvency Proceedings 1346/2000, 2000 O.J. (L 160) 1, pmb1., para. 9 (EC).

9. *Id.* arts. 2(h), 3(2).

10. See discussion *infra* Part II.B.

11. U.N. Comm’n on Int’l Trade Law [UNCITRAL], Working Group on Insolvency Law, *Legislative Guide on Insolvency Law, Part Three: Treatment of Enterprise Groups in Insolvency*, U.N. Doc. A/CN.9/WG.V/WP.82 (Sept. 1, 2008).

12. See discussion *infra* Part III.

13. Working Group on Insolvency Law, *supra* note 11, para. 2.

II. SO WHAT IS THE PROBLEM?

One thing, at least, is clear: the major industrial countries have identified enterprise groups as a threat on a number of fronts. At the same time, enterprise groups have been left to act with considerable freedom and flourish both within national boundaries and across borders, in the developed capitalist world and in developing countries. This conundrum is similar to, if not identical to, that which may be said to exist in relation to a single corporation and which arises from two fundamental concepts of corporate law: the independent legal personality of a corporation and the limited liability of shareholders.

Our conception of the corporation is that of a fully-fledged actor on the commercial scene, endowed with legal capacity, as in the case of any sane adult. This, coupled with the fact (at least in the Anglo-American world) that such corporate actors can be created and inserted into commercial arrangements with the same ease as entering into a contract with a wholly willing partner, offers the entrepreneur an untold luxury of possibilities.¹⁴ In the world of private law, the entrepreneur can, for example, seek to use this facility to protect himself from liability, avoid tax, enjoy the benefits of employee status when such benefits are unavailable to an individual trader, and seek to avoid contractual obligations. Although, of course, whether or not he is successful might depend on the exercise of the court's discretion.¹⁵

In the world of public law, this facility can be deployed to export production and distribution operations to countries that have more relaxed labor standards and cheaper and more abundant labor. Similarly, an enterprise might create administrative operations in jurisdictions where there is a less onerous business taxation regime, as well as seek to engage in transactions to effect fiscally advantageous losses. Thus, the same facility that enables sound entrepreneurial practice to effect positive business operations to the benefit of all stakeholders and society in general may also be used for abusive, self-serving, fraudulent, and even criminal conduct.

The number and sophistication of abuses, of which this structure is especially capable, have increased. They now range from what many believe to be unacceptable labor practices; large scale, cross-border financial, currency, and accounting manipulation; and anti-competitive conduct;¹⁶ to the avoidance of fiscal and other obligations, including liability for tortious acts.¹⁷ The scale of the problem is such that it is now firmly entrenched in the realms of international law, triggering

14. "By the late nineteenth century, however, the process for granting corporate charters had radically changed. Corporations had become, if not commonplace, then at least not unusual. While the artificial corporate person enjoyed favor among businessmen who sought the protections it offered, it had also become the object of fear among those concerned with the power of concentrated wealth. The states chose to abandon their attempts to regulate corporations through their charters and sought instead to regulate harmful activities, regardless of the form of the economic enterprise." Gregory A. Mark, Comment, *The Personification of the Business Corporation in American Law*, 54 U. CHI. L. REV. 1441, 1441-42 (1987).

15. An issue expressed metaphorically as the veil of incorporation and its lifting or piercing. See discussion *infra* Part II.A.

16. See *Corporate Group—Responsibility of Parent for Conduct of Subsidiary*, Case Comment, 2000 E.C.L.R. N-108 (discussing a Swedish court's finding that Telia AB was liable for the anti-competitive practices of its subsidiary Telia Handel AB).

17. See generally *Adams v. Cape Indus. Plc.*, [1990] Ch. 433 (U.K.) (discussing liability of a parent company as a result of a subsidiary company engaging in tortious acts relating to asbestos).

the negotiation of a number of significant multilateral treaties and placing on domestic courts public and private international legal challenges that only a generation or two ago would have been inconceivable. Thus, the problem is how to retain the facility for creating and exploiting enterprise groups, while preventing its use for fraudulent, abusive, and criminal use.

A. *Enterprise Groups and the Courts*

Generally, a sophisticated jurisdiction will adopt a two-pronged attack against abusive group enterprise practices. First, a jurisdiction will respond to the excesses and abuses perpetrated by groups through the exercise of judicial discretion in the resolution of disputes. In the nature of court judgments, this also is a response to specific facts, but the courts—certainly in the common law countries—have attempted to develop some general principles in accordance with which to assess whether the actions of one or more entities within a group should be stopped or some other remedy imposed that ignores the separate identity of the entity or entities within the group.

This is what corporate lawyers call lifting or piercing the veil of incorporation. While the personality of the corporation makes it an independent actor on the legal stage, every so often the court will strip away the corporate mask and ascribe directly to those in the corporation who have caused the corporation to act in the way it has, the legal consequences of such actions. Commonly, this is done where a corporation has been created to assist an individual to avoid legal obligations that the individual has undertaken and that he or she now wants to try to evade.¹⁸ The court will describe the corporation as a sham, or by some other synonymous term,¹⁹ and render it ineffective. A simple example will suffice. In *Gilford Motor Co. v. Horne*, Horne, who had been employed by the Gilford Motor Co., agreed not to start his own business within a specific radius and a specific period of time if he left the employment.²⁰ The court swept aside his defense—and that of the company that Horne created—that it was the company and not he that carried on business within the prohibited area and time.²¹

Where those who caused the corporation to act as it did are, themselves, corporations—where, in effect, we have an enterprise group—the court will be considering whether or not to treat two or more corporations and, possibly, other entities within the group as a single legal actor. And where the commercial issue is the liability of one of the entities within the group, this will raise the question whether the group as a whole, or at least another corporation in the group, can be held liable for the debts of another—obviously bankrupt—corporation in the group.

A very good illustration of this question can be seen in *Adams v. Cape Industries Plc.* This was a case of a mass tort suit, where the class of plaintiffs sought

18. See Jennifer Payne, *Lifting the Corporate Veil: A Reassessment of the Fraud Exception*, 56(2) CAMBRIDGE L.J. 284, 284 (1997) (discussing the so-called “fraud exception” generally).

19. See Murray A. Pickering, *The Company as a Separate Legal Entity*, 31 MOD. L. REV. 481, 481–83 (1968), for an entertaining and illuminating discussion.

20. [1933] Ch. 935, 939–40 (Eng.).

21. *Id.* at 943.

compensation for personal injury caused by the defendant.²² The injury was caused by asbestos that was mined in South Africa and distributed in the United States by corporations in which Cape Industries plc had a controlling shareholding, although latterly it had taken steps to eliminate its connection with the American subsidiary by disposing of its shares.²³ Cape Industries refused to appear before the court in Texas where the personal injury suit was brought (successfully, in that it resulted in a judgment in favor of the plaintiffs), so the plaintiffs brought suit in the U.K., where Cape Industries plc was registered, to have the judgment of the Texas court enforced against Cape.²⁴ This litigation tested two principles that courts have used to extend liability within an enterprise group: first, treating all the separate entities as an economic unit and therefore justifying an order against all the members of the group, and, second, treating the successfully sued entity as the agent for the other members of the group, or at least for the entity that controlled and directed the conduct of that defendant.²⁵ The U.K.'s Court of Appeal refused to extend liability to Cape Industries, holding that Cape Industries was an independent legal entity and, therefore, was not responsible for the debts of other entities, albeit entities with which it had enjoyed a close association.²⁶

The bankruptcy implications of this set of circumstances are clear. If either the agency or economic unit arguments succeed, the basis of the original claim should not matter. It does not have to be established, for example, that the wrong alleged in the *Adams* case was actually perpetrated by the holding corporation or by the other corporations in the group. Their liability would arise simply by reason of the principle of agency (the defendant did what they caused it to do — *qui facit per alium facit per se*) or because if the circumstances are such that the group is an economic unit, then by definition, the group is liable. It is really the reverse of the principle that an independent legal entity, alone, is responsible for its own contractual obligations undertaken or for any tort that it has perpetrated.

Many jurisdictions have seen the obvious justice of this sort of claim, but it is not only the U.K.'s courts that have found them too radical. The independent status of a separate corporation is a very sacred cow in the U.K., but to be fair, many other jurisdictions also struggle when asked to deny the existence of this independent status, without statutory support, and unless the circumstances so clearly dictate, such as cases where the corporation is an obvious sham, where it provides the mechanism for what would be a clear avoidance of the consequences of an unjustified and irremediable breach of contract, or is in some other way clearly abusive. The U.K. has had its rebel judges. One of the greatest was Lord Denning. In *Littlewood Stores v. Inland Revenue Commissioners*, where a carefully devised tax avoidance scheme was successfully challenged by the Inland Revenue, he said:

I decline to treat the Fork Manufacturing Co. Ltd. as a separate and independent entity. The doctrine laid down in *Salomon v. Salomon & Co.*, has to be watched very carefully. It has often been supposed to cast a veil over the personality of a limited company through which the courts cannot see. But that is not true. The courts can and often do draw aside the veil.

22. *Adams v. Cape Indus. Plc.*, [1990] Ch. 433, 434 (Eng.).

23. *Id.* at 434–37.

24. *Id.*

25. *Id.*

26. *Id.*

They can, and often do, pull off the mask. They look to see what really lies behind. The legislature has shown the way with group accounts and the rest. And the courts should follow suit. I think that we should look at the Fork Manufacturing Co. Ltd. and see it as it really is—the wholly-owned subsidiary of Littlewoods. It is the creature, the puppet, of Littlewoods, in point of *fact*: and it should be so regarded in point of law.²⁷

The great Professor Gower played his part in trying to spur on this rebellion. In the third edition of his “bible,” after analyzing some of the earlier cases on this point, he urged that, “[T]here is evidence of a general tendency to ignore the separate legal entities of various companies within a group and to look instead at the economic entity of the whole group.”²⁸ Lord Denning promptly endorsed this notion in the following terms:

This is especially the case when a parent company owns all the shares of the subsidiaries—so much so that it can control every movement of the subsidiaries. These subsidiaries are bound hand and foot to the parent company and must do just what the parent company says.²⁹

Neither of the cases in which Lord Denning expressed these somewhat heterodox views was concerned with payment of debt.³⁰ Indeed, in the *D.H.N.* case, the group actually benefited from being treated as a single entity, gaining compensation that would have been denied had the separate identity of the constituent corporations been maintained.³¹ And aside from the doubts expressed, there can be no doubt that the higher courts in the U.K. have recently taken the opportunity to emphasize the traditional approach.³²

It is beyond doubt that enterprise groups pose issues and problems for society as a whole. At this level of abstraction, these are political and economic issues, and one may sympathize with the courts resisting the call to be involved in the control, or more, of enterprise groups without specific legislative authority to do so. Does similar reasoning apply on the much more private level where the creditors of one group member suffer loss on account of the latter’s bankruptcy, while the other group members may have profited through the work and discoveries of their bankrupt child and sibling? The latter seems unfair and offensive to the principle that creditors are to be preferred to shareholders, especially given the potential for an enterprise group to manipulate assets and liabilities among the different group members.

In fact, the courts have not stood entirely aside from this conflict. The obvious principle that fraud would not be tolerated was soon established, even if this meant

27. *Littlewood Mail Order Stores v. Inland Revenue Comm’rs*, [1969] 1 W.L.R. 1241, 1254 (Eng.).

28. L. C. B. GOWER, *MODERN COMPANY LAW* 216 (K. W. Wedderburn, O. Weaver, & A. E. W. Park eds., 3d ed. 1969).

29. *D.H.N. Food Distributions Ltd. v. Tower Hamlets London Borough Council*, [1976] 1 W.L.R. 852, 860 (Eng.).

30. The *D.H.N.* dicta were expressly questioned shortly afterwards by Lord Keith in *Woolson v. Strathclyde Reg’l Council*, [1978] S.C. 90, 96 (H.L.) (Eng.) (“I have some doubts whether in this respect the Court of Appeal properly applied the principle that it is appropriate to pierce the corporate veil only where special circumstances exist indicating that is a mere façade concealing the true facts.”).

31. *D.H.N. Food Distributions Ltd.*, [1976] 1 W.L.R. at 857.

32. See *Ord v. Belhaven Pubs Ltd.*, [1998] B.C.C. 607, 615 (Eng.) (approving of the *Adams* decision).

disregarding the sacred veil of incorporation.³³ A closely related principle—that the separate status of a company should be disregarded where the only function of the company was to enable an individual to evade a legal obligation—again caused little controversy or judicial trauma.³⁴ But this is as far as the English courts have been prepared to go in the enunciation of general principles. There have been brief flirtations with the principle that a company is the agent of the principal shareholder (in our terms, a subsidiary as an agent of the holding company),³⁵ even a trustee for the shareholder as beneficiary (recalling the principle that the beneficiary is liable to indemnify the trustee).³⁶

Specifically in cases of enterprise groups, the dominant approach of the U.S. courts is to maintain the integrity of the separate entity doctrine, unless the corporate shareholder (in effect, the holding company) dominates the subsidiary company or the corporate shareholder has engaged in fraudulent, illegal, or other improper conduct.³⁷ These principles may be more radical than those of the English courts, but they are still measured and sometimes even cautious. It seems clear, for example, that for the principal company to be stripped of its separate status on the ground of controlling the subsidiary, that control must amount to total domination.³⁸ Moreover, in the absence of such domination, there must be clear evidence of the creditor having been misled into believing that he or she was dealing with the parent company.³⁹ In the context of the enterprise group, the issue of involuntary as against voluntary creditors has also surfaced in the United States, with the courts being more sympathetic to the demand of the former to lift the veil of the corporation. The voluntary creditor, one who has entered into a contract with the corporate group member, it is often observed, at least had the chance to forego the opportunity of entering into that relationship.⁴⁰ The involuntary creditor—for example, the successful tort claimant in a suit against the enterprise group member—had no such choice.⁴¹

The principle of equitable subordination, developed by the U.S. courts, deserves special mention. The literature and case law on this principle is now vast.⁴²

33. See generally, e.g., *In Re Darby*, [1911] 1 K.B. 95 (Eng.) (disregarding the entity in face of fraud).

34. See, e.g., *Gilford Motor Co. v. Horne*, [1933] Ch. 935, 948–49 (Eng.) (explaining that the company was created simply to avoid an existing legal obligation); see also *Jones v. Lipman*, [1962] 1 W.L.R. 832 (Ch.) (Eng.) (mirroring the *Gilford* decision); *In Re Bugle Press*, [1961] Ch. 270 (Eng.) (preventing forced sale of shares to a sham corporation at below market price); *Wallersteiner v. Moir*, [1974] 1 W.L.R. 991 (Eng.) (pulling aside the corporate veil in the case of fraud).

35. See generally *Smith, Stone & Knight v. Birmingham Corp.*, [1939] 4 All ER 116 (K.B.) (Eng.) (holding that a subsidiary acted on behalf of the parent company).

36. See generally *D.H.N. Food Distribs. Ltd. v. Tower Hamlets London Borough Council*, [1976] 1 W.L.R. 852 (Eng.) (benefitting both the company and its shareholders). See *Woolfson v. Strathclyde Reg'l Council*, [1978] S.C. 90, 96 (H.L.) (Eng.), for a strong criticism of this decision a year later.

37. See Meredith Dearborn, Comment, *Enterprise Liability: Reviewing and Revitalizing Liability for Corporate Groups*, 97 CAL. L. REV. 195, 231–51 (2009) (giving an overview of enterprise liability in the United States).

38. *U.S. v. Jon-T Chem., Inc.*, 768 F.2d 686, 690–91 (5th Cir. 1985); *In re Amoco Cadiz* 954 F.2d 1279, 1302–03 (7th Cir. 1992).

39. *Am. Trading & Prod. Co. v. Fischbach & Moore*, 311 F. Supp. 412, 415–16 (D.C. Ill. 1970).

40. See, e.g., *Yoder v. Honeywell Inc.*, 104 F.3d 1219, 1222 (10th Cir. 1997) (noting the consensual nature of a contract transaction).

41. See *id.* at 1222 (noting the lack of voluntary dealings in most tort cases); *Mancorp, Inc. v. Culpepper*, 836 S.W.2d 845, 847–48 (Tex. App.—Houston [1st Dist.] 1992) (comparing tort and contract transactions with regard to choice).

42. See BLUMBERG, *supra* note 2, ch. 4 (providing a general analysis of equitable subordination where

As its name suggests, it is based on an assessment of the conduct of one of the creditors, which if found to be inequitable, may result in the claim being subordinated to that of other creditors.⁴³ It is an additional requirement for the application of this principle that the inequitable conduct should also have resulted in a detriment to the other creditors.⁴⁴

Technically, there is an important difference between lifting the veil and equitable subordination. In the case of the former, there is a creditor and a debtor, whereas in the case of equitable subordination there are two creditors. But the effect of the application is identical. In the first case, the creditor's claim is assigned to a debtor better able to satisfy it. With equitable subordination, both creditors' claims remain in existence, but one goes to the bottom of the pile and is removed from the level on which it formerly competed with the outside creditor's claim, thus in effect indirectly funding the outside creditor's claim.

English law has two interesting parallels. In the law of partnership, a claim by a loan creditor can be subordinated to claims of trade creditors and lost altogether where the "lender" is found to have been a partner.⁴⁵ In the United States, the issue has been much debated whether the under capitalization of a subsidiary corporation is, per se, sufficient for the application of the principle of equitable subordination against a claim by the principal corporation, especially where, as is likely, this claim is based on a loan in lieu of share capital.⁴⁶ The balance of opinion seems to be not.⁴⁷

Second, in English law, where dividends have been declared but insolvency prevents their being paid, shareholders are deemed not to be creditors in respect of these unpaid dividends and are, in effect, subordinated in respect of these unpaid dividends to the claims of all other creditors.⁴⁸

B. *Enterprise Groups and Legislation*

A country might legislate to try to prevent excessive and egregious conduct on the part of enterprise groups. Such legislation, especially in common law countries, is likely to be specific in nature. Thus far, Germany remains the only country to have attempted general legislation that centers on the creation of the institution of enterprise group law⁴⁹—*Konzernrecht*—but even this is quite limited in its extent.⁵⁰ In common law countries, the public regulation of companies and corporations has tended to come in fits and starts, often associated with the emergence of abusive and fraudulent practices and consequent bankruptcies in the operation of such

parent and subsidiary corporations are involved).

43. *Id.* at 16–19.

44. *Id.* at 17–18.

45. Partnership Act, 1890, 53 & 54 Vict., c. 39, § 3 (Eng.).

46. BLUMBERG, *supra* note 2, at 133–36.

47. *Id.* at 135; *see also In re Lifschultz Fast Freight* 132 F.3d 339, 344–46 (7th Cir. 1997) (discussing the weight of undercapitalization).

48. Insolvency Act, 1986, c. 45, § 74(2)(f) (U.K.).

49. Hofstetter, *supra* note 1, at 579.

50. *See id.* at 579–82 (providing an account of the extent of the legislation); *see also* N.C. Sargent, *Beyond the Legal Entity Doctrine: Parent-Subsidiary Relations Under the West German Konzernrecht*, 10 CAN. BUS. L.J. 327 (1985); KLAUS J. HOPT, *Legal Elements and Policy Decisions in Regulating Groups of Companies* in *GROUPS OF COMPANIES* (Clive M. Schmitthoff & Frank Wooldridge eds., 1991).

companies and corporations.⁵¹ This has included legislation aimed at the organization and practices of members of an enterprise group. This legislation defines circumstances, on the occurrence of which, the association between any two or more companies will be held to have arisen and which will, therefore impose on the companies so associated, certain obligations (for example, as to disclosure of information not otherwise imposed on companies).⁵² The U.K. model provides a twofold approach. In the first place, the legislation defines what it calls “holding” and “subsidiary” companies in the following terms:

A company is a “subsidiary” of another company, its “holding company”, if that other company—

- (a) holds a majority of the voting rights in it, or
- (b) is a member of it and has the right to appoint or remove a majority of its board of directors, or
- (c) is a member of it and controls alone, pursuant to an agreement with other members, a majority of the voting rights in it, or if it is a subsidiary of a company that is itself a subsidiary of that other company.⁵³

Charmingly, in Germany and some other European countries the corresponding terms are mother and daughter companies!⁵⁴ Obviously the creation of such relationships is not per se illegal, but certain transactions between holding and subsidiary companies may be illegal. One of the most common of these illegal transactions is the holding of any shares of stock by the subsidiary in the holding company.⁵⁵ This is seen as a return of capital by a corporation to its shareholders without the permission of the court. If the subsidiary company is insolvent, it could also be seen as an attempt to subvert one of the fundamental principles of English bankruptcy law, namely preferring the debtor to the creditor.⁵⁶

Other examples of legislative regulation of associations of corporations relate to the conduct of business by companies and their officers. In one case, the publication of accounts, the statutory provisions lift the veil of incorporation by requiring holding and subsidiary companies to publish consolidated financial statements.⁵⁷ Indeed, the legislation even goes so far as to recognize the group itself, although only in this very limited sphere. Thus, “[i]f at the end of a financial year the company is a parent company the directors, as well as preparing individual

51. See, e.g., Thomas W. White, *New US Corporate Reform Law*, WILMER, CUTLER, & PICKERING CORP. GOVERNANCE GUIDE 2002, available at <http://www.wilmerhale.com/files/Publication/4ab21ebb-596b-4957-a37a-8bca41b21894/Presentation/PublicationAttachment/ac870a45-51cb-411d-827c-0bc1992f502d/White,%20T.-Corporate%20Finance%202002.pdf> (acknowledging that Sarbanes-Oxley responded to corporate scandals).

52. See, e.g., JENNIFER PAYNE, TAKEOVERS IN ENGLISH AND GERMAN LAW 44–45 (2002) (noting German disclosure obligations for parent-subsidiary and takeover relationships).

53. Companies Act, 2006, c. 46, § 1159(1) (U.K.).

54. See generally, e.g., Gunnar Hedlund, *Organization In-Between: the Evolution of the Mother-Daughter Structure of Managing Foreign Subsidiaries in Swedish MNCS*, 15 J. OF INT'L BUS. STUDIES 109 (1984) (illustrating use of the terms).

55. See, e.g., Companies Act 2006 § 136 (establishing subsidiary prohibitions of ownership).

56. See ALISTAIR ALCOCK, ET AL., COMPANIES ACT 2006: THE NEW LAW 98–99 (2007) (attributing the restriction to the principle of capital maintenance).

57. Companies Act 2006 § 405.

accounts for the year, must prepare group accounts for the year unless the company is exempt from that requirement.”⁵⁸ Group accounts are defined as:

- (a) a consolidated balance sheet dealing with the state of affairs of the parent company and its subsidiary undertakings, and
- (b) a consolidated profit and loss account dealing with the profit or loss of the parent company and its subsidiary undertakings.⁵⁹

We might view this provision as one that treats all the members of the group as a single enterprise. Building on this, the argument that closely associated corporations should be treated collectively as an enterprise has been urged on the courts from time to time in circumstances far removed from the matter of publication of accounts, as mentioned above.⁶⁰ It must be said, however, in line with their generally conservative approach, that English and Scottish courts have rarely accepted this argument,⁶¹ especially where the consequences would be to remove from the shareholders the protection of limited liability, even though the shareholders in this case are other incorporated companies.⁶²

Although the Companies Act’s provisions have been singularly unhelpful to the argument that the activities of all members of an enterprise group might constitute a single enterprise unit, the same cannot be said for the Insolvency Act of 1986. While the latter does not especially have enterprise groups in mind, it does provide the basis on which the management of the corporation may be required to contribute to the assets of the corporation in insolvent liquidation.⁶³ The Insolvency Act here purported to implement that part of “Insolvency Law and Practice—The Report of the Review Committee,” which expressed its recommendation in the following terms:

Clearly, conduct which under the present law constitutes fraudulent trading must continue to expose those responsible to civil, as well as criminal, liability. But we intend the new civil liability for wrongful trading to be far wider than that. In future, we propose that a company shall be trading wrongfully if, being insolvent or unable to pay its debts as they fall due, it incurs liabilities to other persons without a reasonable prospect of meeting them in full; and that a person who was party to the carrying on of the company’s trading may be made personally liable for the debts of the company if he knew or, as an officer, ought to have known that the trading was wrongful.⁶⁴

58. *Id.* § 399(2).

59. *Id.* § 404(1).

60. *See supra* notes 27–29.

61. *Adams v. Cape Indus. Plc.*, [1990] Ch. 433, 436 (Eng.); *Wolfson v. Stratheylde Reg'l Council*, [1978] S.C. 90, 90–91 (H.L.) (Eng.).

62. Charles Mitchell, *Lifting the Corporate Veil in the English Courts: An Empirical Study*, 3 *CORP. FIN. & INSOLVENCY L. REV.* 15, 21–22 (1999).

63. *See* Insolvency Act, 1986, c. 45, § 214 (U.K.) (setting out rules regarding wrongful trading).

64. SECRETARY OF STATE FOR TRADE, *INSOLVENCY LAW AND PRACTICE—REPORT OF THE REVIEW COMMITTEE*, 1982, Cmnd. 8558, at para. 1781.

Section 214 of the Insolvency Act does, in fact, empower the court to impose liability for the debts of an insolvent corporation in liquidation on a director where it is found that at some time before the corporation went into insolvent liquidation, the director (a) “ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation” and (b) failed to take “every step with a view to minimising the potential loss to the company’s creditors. . . .”⁶⁵

Negligent trading thus joined fraudulent trading as a basis for making management liable to contribute to the assets of the corporation in insolvent liquidation. The theoretical significance of this provision in the present context lies, however, in its conjunction with another novel provision of the Insolvency Act, namely the definition of “shadow director” as “a person in accordance with whose directions or instructions the directors of the company are accustomed to act. . . .”⁶⁶ Thus, where the directors of a subsidiary corporation act as directed by the directors of the holding corporation, and the subsidiary goes into insolvent liquidation within the terms of section 214, the holding corporation or its directors might be held to be shadow directors and made to contribute to the assets of the insolvent corporation, thereby losing their protected limited liability status.

The Insolvency Act made further inroads into the sanctity of the separate entity of closely connected corporations in laying down the conditions in which associate status would arise. In the course of the complicated provision that deals as much with individuals and partners as with corporations,⁶⁷ it is provided first that:

A company is an associate of another company—

if the same person has control of both, or a person has control of one and persons who are his associates, or he and persons who are his associates, have control of the other, or

if a group of two or more persons has control of each company, and the groups either consist of the same persons or could be regarded as consisting of the same persons by treating (in one or more cases) a member of either group as replaced by a person of whom he is an associate.⁶⁸

Second, it provided “[a] company is an associate of another person if that person has control of it or if that person or persons who are his associates together have control of it.”⁶⁹

These provisions, when combined with a further provision which defines when a person is “connected” with the company,⁷⁰ extend the power of the liquidator of a corporation in setting aside transactions undertaken prior to the liquidation, that had the effect of favoring the transferee at the expense of the other creditors. Where the transferee is a corporate entity within the same enterprise group as the corporation in liquidation, it is likely to satisfy the definition of being an associate or connected person, thereby giving the liquidator a dual advantage in the attempt to set aside the

65. Insolvency Act 1986 § 214(1)–(3).

66. *Id.* § 251.

67. *Id.* § 435.

68. *Id.* § 435(6).

69. *Id.* § 435(7).

70. Insolvency Act 1986 § 249(b).

relevant transactions. The primary advantage is that the period within which pre-liquidation transactions may be set aside is considerably lengthened.⁷¹ Second, the associated corporation will not have the benefit—available to non-associated transferees—of the presumption that the transferee acted in good faith.⁷²

These are some of the examples by which legislation in the U.K. has recognized and sought to prevent the possible abuses to which the phenomenon of enterprise groups might give rise. Other countries have also followed this piecemeal approach.

In the United States any state and federal legislation that seeks to eliminate the distinction between separate corporations within the same group tends to be in areas that are perceived to be of great public concern and interest, such as public utilities, antitrust, fiscal incidence, and—reflecting here a substantial cultural difference between the United States and the U.K.—banking.⁷³ As in the U.K., no legislation seeks directly to impose liability on a corporation for the debts of an associated corporation. On the other hand, in matters of insolvency, a less cautious judiciary has pursued the development of the enterprise notion of breaking down the protections of separate entity status through the application of common law doctrines such as equitable subordination.⁷⁴ The following quotation from the work of one of this generation's leading scholars on enterprise groups summarizes the position in the United States:

The five volumes of *The Law of Corporate Groups* published previously have attempted to describe the increasing unacceptability of the concept of entity and the emergence of a doctrine of enterprise law with respect to many aspects of the legal relationships of parent and subsidiary corporation, particularly where substantive liability is not involved. Of enormous significance in our legal system, this change reflects a growing unwillingness on the part of the courts and the legislatures to continue to accept the traditional view of the law of the corporation when it no longer corresponds to the reality of the modern business enterprise in a complex industrialized international society.

Where, however, substantive liability is at stake and the traditional conceptual view of the separate legal personality of the corporation is strengthened by the principle of limited liability of shareholders, as in cases involving the attempted imposition upon one affiliate of a corporate group of liability for the torts or contracts of another affiliate of the group, entity law still retains much of its vigor.⁷⁵

A similar picture, illustrating a tension between the entity and enterprise approach to enterprise groups, would seem to characterise Australian law and practice. As in the U.K. and the United States there is a growing disparity between the legal principles emphasizing the significance of separate entity status of each

71. *Id.* § 240(1)(a), (b).

72. *Id.* § 241(2A).

73. *E.g.*, Public Utility Holding company Act of 1935, 49 Stat. 803 (codified as amended at 15 U.S.C. §79 et seq. (2006)). The PUHCA forces public utility companies to be treated as single, integrated systems.

74. *E.g.*, *In re Owen Corning*, 419 F.3d 195 (3d Cir. 2005).

75. PHILLIP I. BLUMBERG & KURT A. STRASSER, *THE LAW OF CORPORATE GROUPS: PROBLEMS OF PARENT AND SUBSIDIARY CORPORATIONS UNDER STATUTORY LAW SPECIFICALLY APPLYING ENTERPRISE PRINCIPLES* XXXIII (1995).

corporation and the popular perception of a corporate group as a single enterprise. In *Qintex Australia Finance Ltd. v. Schrodgers Australia Ltd.*, where many of the corporations within the group were insolvent, one of the witnesses who dealt with the group said, “[I]t was not my practice to ask which of the Qintex companies was responsible for the deal. I always treated the client as Qintex and did not differentiate between companies in the group”⁷⁶ The judge summed up this disparity in the following terms:

Regularly, liquidators of subsidiaries, or of the holding company, come to court to argue as to which of their charges bears the liability. . . .As well, creditors of failed companies encounter difficulty when they have to select from among the moving targets the company with which they consider they concluded a contract. 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.⁷⁷

Australia however, has enacted legislation specifically aimed at the mischief of holding companies allowing their subsidiaries to incur debts as they decline into insolvency to the detriment of their creditors. The section in question provides as follows:

A corporation contravenes this section if: (a) the corporation is the holding company of a company at the time when the company incurs a debt; and (b) the company is insolvent at that time, or becomes insolvent by incurring that debt, or by incurring at that time debts including that debt; and (c) at that time, there are reasonable grounds for suspecting that the company is insolvent, or would so become insolvent, as the case may be; and (d) one or both of the following subparagraphs applies: (i) the corporation, or one or more of its directors, is or are aware at that time that there are such grounds for so suspecting; (ii) having regard to the nature and extent of the corporation’s control over the company’s affairs and to any other relevant circumstances, it is reasonable to expect that: (A) a holding company in the corporation’s circumstances would be so aware; or (B) one or more of such a holding company’s directors would be so aware. . .⁷⁸

If the requirements of the section are met, the liquidator may recover an amount equal to the loss or damage suffered by the creditors.⁷⁹ It is a defense if the directors can establish that they had reasonable grounds to believe that the

76. (1990) 3 A.C.S.R. 267, 268 (Austl.).

77. *Id.* at 268–69. Compare the following comment of Templeman L.J., as he was then: “A parent company may spawn a number of subsidiary companies, all controlled directly or indirectly by the shareholders of the parent company. If one of the subsidiary companies, to change the metaphor, turns out to be the runt of the litter and declines into insolvency to the dismay of its creditors, 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.” *In re Southard & Co. Ltd.* (1979) 1 W.L.R. 1198, 1208 (C.A. Civ. Div.) (Austl.).

78. Corporations Act, 2001, § 588V(1) (Austl.).

79. *Id.* § 588W(1)(d).

subsidiary company was solvent or were reasonable in relying on information being provided as to the solvency of the subsidiary.⁸⁰

Both the Australian and U.K. legislatures have attempted a similar radical step: to provide a basis for liability of management where their conduct of the company prior to its descent into insolvent liquidation was negligent. Neither is free from criticism,⁸¹ although it should be remembered that such legislation encroaches on the traditional protection available to management of limited liability and, ultimately, on the incentive to undertake risky, entrepreneurial activity.

C. *Enterprise Groups and International Jurisdiction*

The widespread phenomenon of enterprise groups has—as some of the authorities mentioned above—provoked something of a shift in the way we think about what might be appropriate in legal principles to ensure fairness and justice between the various interests that make up our commercial world. Change is happening, but many would argue that the ways of the *ancien regime* are deeply entrenched and remarkably tenacious.

There is another major force that is provoking a rethink of traditional legal principles—globalization, through which the internationalization and regionalization of commercial operations and practice are proceeding apace. National courts and other institutions are under increasing pressure to solve legal problems that spill over national boundaries and press local legal principles and comparative ingenuity to greater and greater lengths (in some countries to better effect than others). It may well be, however, that real progress in this regard will come from international bodies that have the advantage of combining the multiple jurisdictions of their constituent members from which to forge an international governing system. Their disadvantage lies in the tension this establishes between whatever international system is established and the municipal systems of the constituent members. Still, we have very able examples of federally governed countries from which to learn productive lessons in ensuring the positive coexistence of an international organization and its constituent members. In the field of commercial and corporate governance, the European Union has made great strides in this regard.

D. *The European Union and the Regulation of Enterprise Groups*

Since its foundation in 1958 as a six country-member regional organization,⁸² the European Union has consisted of four major institutions—the Council, the

80. *Id.* § 588X(2), (3).

81. *See, e.g.,* Ramsay, *supra* note 3, at 367–77 (providing an evaluation of § 588V of Australia's Corporations Act).

82. Belgium, Federal Republic of Germany, France, Holland, Italy, and Luxembourg constituted what was then the European Economic Community, the European Coal and Steel Community, and the European Atomic Energy Community (“the European Communities”). Europa: The History of the European Union, 1945–1959, http://europa.eu/abc/history/1945-1959/index_en.htm (last visited Apr. 4, 2009).

Commission, the Assembly or Parliament, and the Court of Justice.⁸³ These institutions and the relationships between them have evolved substantially during the first fifty years of the life of the EU, not least because the membership has increased from six to twenty-seven country-members. The EU has legislative capacity, in terms of which it may enact instruments whose provisions are binding throughout the territory of the EU, as well as instruments that are binding on the governments of the member-states, principally so that the latter should take municipal legislative steps to bring their own laws into harmony with declared EU ends. Legislation of the former kind is usually enacted in a form of legislation known as a Regulation, and the latter type of legislation is usually in the form of a Directive. Both have relevance for us, and we should also note that the Court of Justice has final and supreme jurisdiction on, inter alia, matters of EU law, which for present purposes may be restricted to the interpretation and application of legislative instruments of the EU.

There are several paths by which contentious issues can be brought before the Court of Justice, but there is no doubt that where that Court rules on a matter of EU law, that ruling is binding on all the courts (and legislatures) of the member-states. The relative powers of the EU and member-states is far from resolved, but few doubt the considerable weight of authority carried by the decisions of the Court of Justice.⁸⁴ What follows is a description of two initiatives taken by the EU in matters of relevance to the themes of this article, one illustrating the weakness of the EU and the other, arguably, its growing strength.

The first of these initiatives fell within a longstanding EU program of Corporate Law harmonization. Under this program, the EU has made proposals in the form of Directives to the member-states to implement proposals in these Directives so as to effect a harmonization of Corporate Law principles throughout the EU.⁸⁵ Fifteen Directives have been enacted by the EU and implemented by the member-states on various Corporate Law issues, such as the regulation of takeovers, insider trading, corporate accounts, protection of third party creditors, levels of capitalizations, and so on.⁸⁶

In the 1980s, the EC issued a draft of what was proposed as the Ninth Draft Company Law Harmonization Directive (the so-called “Groups of Companies Directive”).⁸⁷ It was intended that this Draft should mature into a permanent Directive setting out agreement among all the member-states as to the conditions under which an enterprise group would be determined as such and also the basis on which the group might be treated as a single entity.⁸⁸ However, the matter became controversial in the European Community’s own body—the Commission (one of the four major institutions of the EU)—and this Directive never got beyond the preliminary draft stage.⁸⁹ It has to be said that even if it had progressed beyond the

83. See Europa, EU Institutions and Other Bodies, http://europa.eu/institutions/index_en.htm (last visited Mar. 30, 2009) for more information on the European Union.

84. See Daniel J. Meltzer, *Member State Liability in Europe and the United States*, 4 INT’L J. CONST. L. 39, 69 (2006) (discussing limits of power of the European Court of Justice).

85. The European Commission Directives are available at http://ec.europa.eu/internal_market/company/official/index_en.htm.

86. European Commission: The EU Single Market, Directives and Other Official Acts, http://ec.europa.eu/internal_market/company/official/index_en.htm (last visited Apr. 4, 2009).

87. Roel Nieuwedorp, *EEC Company Law Harmonisation*, 15 INT’L BUS. L. 177, 179 (1987).

88. *Id.*

89. *Id.* at 180.

Commission, it seems highly unlikely that it would ever have secured the unanimous agreement of the member-states, except, possibly, in the most anodyne and ineffectual form.⁹⁰

Another Draft Company Law Harmonization Directive that never got beyond the draft stage was one that sought to harmonize the form of governing boards for large public corporations.⁹¹ Initially, it was intended that this should follow the model established in the then Federal Republic of Germany with its distinctive system of *Mitbestimmung* (Co-Determination), under which there are two Boards of Directors.⁹² There is the Supervisory Board, which is elected by both shareholders and employees and which, in turn, appoints the Management Board.⁹³ The latter is in day-to-day charge of the corporation and the Supervisory Board has control of issues of long-term strategy.⁹⁴ This Directive, too, after much discussion and many attempts to sweeten its terms for the rejectionist countries (of which the U.K. may have been the most vociferous), failed to get past the draft stage.⁹⁵

The EU initiative that, arguably, looks as though it may be on the way to success lies in the area of bankruptcy. Bankruptcy brings two big issues concerning enterprise groups to the fore. First, in what circumstances will the other members of the group be made liable for the debts contracted by a member of the group? Second, given the likelihood of an enterprise group having members based in different jurisdictions, what, if any, provisions exist to centralize the bankruptcy of some or all of the members of the group? The first may be said to be the national issue and the second, the international issue. They may also be distinguished as substantive and procedural issues, respectively. But they are also interdependent in that the “international” or procedural issue may be defined to incorporate the national or substantive issue.

The European Union enacted the Regulation on Insolvency Proceedings,⁹⁶ which applies throughout twenty-six of its twenty-seven member-states—Denmark excluded itself.⁹⁷ So this is a truly international measure, though some may prefer to call it regional. Here we will find provisions that lay down which of the national legal systems will apply in different given circumstances. The truly international aspect of this measure is the overall structure, which applies to all member-states—the skeleton, as it were. And, correspondingly, the national or municipal legal provisions constitute much of the flesh and blood. I shall first identify some of the central features to this Regulation.

90. The Financial Services and Companies Division (5) of the U.K.’s Department of Trade and Industry published a Consultative Document on this draft Directive in February 1985.

91. See Janet Dine, *Implications for the United Kingdom of the EC Fifth Directive*, 38 INT’L & COMP. L.Q. 547, 547 (1989) (stating that “the laws of member States regarding the structure of public companies” was one of the main objectives that the Directive intended to address).

92. *Id.*; see also Thomas P. Conlon, *Industrial Democracy and EEC Company Law: A Review of the Draft 5th Directive*, 24 INT’L L. & COMP. L.Q. 348, 350–52 (1975) (discussing the origins of the two-tier system of management in nineteenth-century German financing arrangements).

93. See Dine, *supra* note 91, at 548–50.

94. See *id.* at 547–50 (discussing the roles of the supervisory and management organs).

95. See *id.* at 552–53 (discussing the opposition with which the draft was met after its most recent release in March 1987).

96. Regulation on Insolvency Proceedings 1346/2000, 2000 O.J. (L 160) 1 (EC). Although enacted in May 2000, the Regulation came into force on May, 31 2002. *Id.* art. 47.

97. *Id.* at pmb., para. 33.

First, the Regulation seeks to establish a choice of law for the management of any insolvent debtor whose business activities stretch over at least two EU member-states.⁹⁸ This is done by reference to the concept of a Center for Main Interests (“COMI”), which, when established, dictates which legal system will govern the procedure and some of the substance in the insolvency process.⁹⁹ One might regard this as the default legal system.

Second, there are special opt-out provisions in relation to certain specific claims—essentially claims arising out of contracts of employment and claims under which secured credit rights are asserted.¹⁰⁰ These opt outs—which prescribe the appropriate regimes for governing such claims—reflect what are significant features of commercial dealings and where the business community would insist on knowing, in advance of any bankruptcy, what legal system would be likely to govern any disputes which might arise. This is well expressed in the preamble to the Regulation in the following terms:

There is a particular need for a special reference diverging from the law of the opening State in the case of rights in rem, since these are of considerable importance for the granting of credit. The basis, validity and extent of such a right in rem should therefore normally be determined according to the *lex situs* and not be affected by the opening of insolvency proceedings. The proprietor of the right in rem should therefore be able to continue to assert his right to segregation or separate settlement of the collateral security.¹⁰¹

A similar point is made with respect to the default rule in the influential Schmidt/Virgos Report on the EU’s Bankruptcy Convention. The EU’s bankruptcy convention preceded the Regulation, remained unenacted, and was eventually swallowed up by the Regulation from which it is largely indistinguishable. The learned authors expressed the more general proposition of the importance of foreseeability in commercial dealings as follows:

The concept of ‘centre for main interests’ must be interpreted as the place where the debtor conducts the administration of his interests on a regular basis and is therefore ascertainable by third parties. The rationale of this rule is not difficult to explain. Insolvency is a foreseeable risk. It is therefore important that international jurisdiction (which as we shall see entails the application of the insolvency laws of that Contracting State) be based on a place known to the debtor’s potential creditors. This enables the legal risks which would have to be assumed in the case of insolvency to be calculated.¹⁰²

98. See *id.* arts. 3–4 (establishing international jurisdiction and applicable law).

99. *Id.* art. 3, paras. 1–3, art. 4, para. 1.

100. See *id.* arts. 8–10 (discussing contracts relating to immovable property, secured claims, payment systems, and contracts of employment).

101. Council Regulation on Insolvency Proceedings 1346/2000, 2000 O.J. (L 160) 1, pmb., para. 25 (EC).

102. *Report on the Convention of Insolvency Proceedings*, E.U. Council Report No. 6500/96, art. 3, para. 75 (May 1996) (prepared by Etienne Schmit & Miguel Virgos), available at http://aei.pitt.edu/952/01/insolvency_report_schmidt_1988.pdf.

Third, the Regulation on Insolvency Proceedings establishes the regimes of main and secondary bankruptcies—the former being that conducted in the jurisdiction of the debtor’s center of main interests, and the latter which can be initiated anywhere within the EU where the debtor has what is described as an “establishment.”¹⁰³

This is a somewhat fragmented system. Three or even more legal systems may be in play in any one multinational bankruptcy within the EU: the default legal system established by the debtor’s center of main interests, the legal systems governing any opt-out claims, and the legal systems governing any secondary bankruptcies. This is no more than the expression of the obvious truth that universalism—the conducting of the entire bankruptcy involving two or more jurisdictions under one law where all the debtor’s estate is collected and where all the creditors’ claims are fairly met—is a long way off. The existence of a form of political union in Europe could not of itself effect this, just as political union in the United States could not effect this even after being in existence for more than two hundred years.

Like the United States, the EU does strive through this Regulation to bring about as much procedural uniformity as possible where there is a multistate bankruptcy. Thus, while the notion of a secondary bankruptcy may be divisive in allowing a different legal system to resolve issues in relation to some of the claims, the Regulation does make huge efforts to ensure proper cooperation between the liquidators of the various bankruptcies.¹⁰⁴

Finally, the Regulation establishes recognition throughout the EU of the various bankruptcy regimes and the officers who conduct them. The court of any country within the EU is required to recognize the credentials of any officer recognized as such in his or her home state,¹⁰⁵ thus paving the way for a smooth, or one might say smoother, operation when a liquidator from the state where the main insolvency is being conducted seeks the recovery of the debtor’s property situated in another member-state.

Thus, there can be much significance attached to establishing where the debtor’s center of main interest is. It may not be easy in the case of a large multinational enterprise group to decide between two or even more places. But however difficult this is, it masks a question that has emerged in the six or so years that the Regulation has been in force and that threatens the effectiveness of this Regulation. Where the debtor (or debtors) consists of a group of associated entities, an enterprise group (to use the UNCITRAL term), is there one or a multiple of “centers of main interest” governing the management of the group’s bankruptcy? Does separate existence entitle each company *ipso facto* to its own center of main interests status, or might one say of the entire group that its operations or the operations of all its constituent parts are really run from the office in state A, and that state A is therefore the debtor’s center of main interests? The issue, in short,

103. Council Regulation on Insolvency Proceedings, *supra* note 101, arts. 2–4, 27.

104. *See, e.g., id.* art. 31, para. 1 (“[T]he liquidator in the main proceedings and the liquidators in the secondary proceedings shall be duty bound to communicate information to each other. They shall immediately communicate any information which may be relevant to the other proceedings, in particular the progress made in lodging and verifying claims and all measures aimed at terminating the proceedings.”).

105. *Id.* arts. 18–19.

will be whether an incorporated organization may insist on its bankruptcy being conducted where it is registered, regardless of its being a wholly owned subsidiary of a holding company situated elsewhere in the EU and regardless of how small a part it may have played in the holding company's EU-wide empire.

A further complication has to be mentioned. Some member-states in the EU have a principle in their corporation law, the "incorporation doctrine," which holds that, regardless of where it conducts its business, a corporation is situated in the country of its registered office.¹⁰⁶ Whereas, the contrary principle, known as the "Real Seat doctrine," that a corporation is deemed to reside in the country where it carries on its activity, applies in other member-states.¹⁰⁷ The Regulation on Insolvency Proceedings sits very neatly on the fence on this issue by describing the determining factor that governs the choice of law as "the centre of a debtor's main interests."¹⁰⁸ The Regulation does establish a default rule, namely, "[i]n the case of a company or legal person, the place of the registered office shall be presumed to be the center of its main interests in the absence of proof to the contrary."¹⁰⁹ But there is a developing line of authority in some of the member-states that is quickly weakening this presumption.¹¹⁰

The challenge to the EU's Regulation on Insolvency Proceedings to deal with the insolvency of enterprise groups was not slow in coming. The first test centered on the location of the COMI. Four cases in particular, in quick succession, have both established and challenged the idea that one location can serve as the COMI for all the members of an enterprise group, despite the fact that they are registered in many different countries.

In *BRAC Rent A Car International Inc.*, the corporation was actually registered in Delaware but conducted all its business from a location in England.¹¹¹ The judgment creditors—probably all or most from England—opposed the grant of an Administration order (which would have had the effect of a moratorium, similar to an automatic stay, on the debts of the debtor corporation and would have provided breathing space to seek restructuring and rescue) and rested their opposition on the ground that the COMI required the debtor to be registered within the EU in order to be susceptible to proceedings under the EU's Regulation on Insolvency Proceedings.¹¹² Here there were no competing European venues for the debtor's COMI,¹¹³ nor was there a group membership issue. However, the vigorous response of the court in accepting England as the debtor's COMI provided a sound basis for positive, controlled creativity in the interpretation of the Regulation.¹¹⁴

106. Peter Behrens, *Centros and the Proper Law of Companies*, CAPITAL MARKETS IN THE AGE OF THE EURO: CROSS-BORDER TRANSACTIONS, LISTED COMPANIES AND REGULATION 505-06 (Guido Ferrarini, Klaus J. Hopt, Eddy Wymeersch eds., 2002).

107. *Id.*

108. Council Regulation on Insolvency Proceedings, *supra* note 101, art. 3, para. 1.

109. *Id.*

110. *In re C4net.com Inc.*, [2004] EWHC 1941, [2005] B.C.C. 277, [20] (Ch.) (U.K.) (Judge Langan stating, "There seems to be to be no reason to suppose that the presumption that a company has its CoMI at the place of its registered office is a particularly strong one. It is, rather, just one of the factors to be taken into account with the whole of the evidence in reaching a conclusion as to the location of the CoMI") [errors in original].

111. [2003] EWHC 128, [2003] B.C.C. 248, [4] (Ch.) (U.K.).

112. *Id.* at [19]-[21].

113. *See id.* at [5] (stating that the company's activities were all governed by English law).

114. *See id.* at [4]-[5] (describing the company's U.K. operations).

In the latest of the four cases, *Collins & Aikmen Corp Group*, the enterprise group was based in Michigan, and the U.S. registered corporation was in Chapter 11 proceedings.¹¹⁵ There were also some twenty-four corporations whose registrations were spread around a number of EU countries.¹¹⁶ On the evidence that the management and administration of the entire European group was conducted in England, the judge made an administration order that included all of the corporations, which, collectively, were the constituent elements of the debtor under the EC regulation.¹¹⁷ Thus, in the result, the judge virtually treated the group as a single unit; however, as in the *BRAC* case, no issue existed between any one member of the group and another.¹¹⁸ No creditor, for example, of any corporation registered elsewhere in the EU sought to establish that jurisdiction as the COMI, either of all the EU corporations or of the corporation against which his claim lay.¹¹⁹ To see how this opposition tests the EU Regulation's capacity to centralize all locations of a bankrupt enterprise group's constituent members, we must look to the other two cases, *Parmalat*¹²⁰ and *Daisytek*.¹²¹ With *Parmalat*, we get our first look at the role of the European Court of Justice.

Both cases involved ongoing disputes, stretching across several borders, over the location of the debtor's COMI. The Parmalat enterprise group seemed firmly based in Italy—in Parma, unsurprisingly.¹²² The Parmalat group included a company that dispensed financial services ("Eurofoods") within the group, and that, for fiscal reasons, was incorporated and situated in Dublin.¹²³ When the Parmalat group crashed into bankruptcy, creditors of Eurofoods sought to protect the assets of that company, and, again unsurprisingly, the liquidator appointed in Parma sought to collect those assets situated in Dublin and to bring Eurofoods under the same bankruptcy regime as the rest of the group's entities.¹²⁴ The Dublin court refused to relinquish jurisdiction on the grounds that Dublin was the COMI of Eurofoods, and, consequently, it appointed an Irish liquidator to the Dublin-based corporation.¹²⁵ The administrator appointed by the court in Parma for the entire Parmalat group appealed this decision, and the Irish Supreme Court brought the European Court of Justice into the drama by referring to the ECJ five questions to determine the COMI of Eurofoods.¹²⁶

The issue thus came before the ECJ, which provides its answers to such questions in the form of a judgment. In accordance with the treaty provisions and the rules of procedure which operate as between the ECJ and the national courts of the member-states of the EU, the national court that submitted the questions then

115. *In re Collins & Aikman Corp. Group*, [2005] EWHC 1754, [2006] B.C.C. 606, [2]–[4] (Ch.) (U.K.).

116. *Id.* at [1]–[4].

117. *Id.* at [13]–[42].

118. *Id.*

119. *Id.*

120. Case C-341/04, *In re Eurofood IFSC Ltd.*, 2006 E.C.R. I-03813.

121. *In re Daisytek-ISA Ltd.*, [2003] B.C.C. 562 (Ch.) (U.K.).

122. *In re Eurofood IFSC Ltd.*, 2006 E.C.R. I-03813, Judgment 1, para. 25.

123. *Id.* para. 26.

124. *Id.* para. 40.

125. *Id.* paras. 41–42.

126. *Id.* paras. 43–44.

applies the answers.¹²⁷ In delivering its judgment, the ECJ is assisted by the opinion of the Advocate General (“AG”), an officer central to the operation of the ECJ and from whose opinion the judgment of the court rarely departs.¹²⁸ In this case, the AG’s opinion advised that the Dublin court’s position be upheld, and the judges of the ECJ accepted this opinion.¹²⁹

To some, this was an unfortunate decision because it set back the attempts to harmonize as far as possible the various processes taking place in the bankruptcy of an enterprise group, especially where all the decisions relating to the operation of the group emanate from a single jurisdiction.¹³⁰ It is possible that the cavalier way in which the group administrator and the court in Parma treated the creditors of Eurofoods, in particular by what was seen as inadequate notice for argument, influenced the AG and the ECJ.¹³¹

The second case, *Daisytek*, involved a substantial electronic office supplies empire, with corporations incorporated, inter alia, in the U.K., France, and Germany.¹³² An English court granted a restraining order—in fact an Administration Order (the U.K.’s business rescue regime)—against all three companies in the U.K., France, and Germany.¹³³ A local French court demurred and declared France to be the COMI of the French company.¹³⁴ This declaration was short-lived; the matter went from the local court in Pontoise to the appeals court of the district in Versailles, which reversed the decision, and this decision was upheld by the French Court of Appeal in Paris.¹³⁵ *Daisytek*, *BRAC Rent A Car International*, and *Collins & Aikman*, arguably, suggest an open-mindedness and a will to centralize bankruptcy proceedings even where the members of a group are incorporated in several different locations. Of course, there was in all three cases, ample evidence that the business of all the members of the group was being managed in England.

The Parmalat decision, which is out of line, is thus far the only decision on the Regulation by the ECJ. It has not been without its critics.¹³⁶ The ECJ rejected the argument of the insolvency administrator of Parmalat that Eurofoods was an integral part of the Parmalat group.¹³⁷ It also applied the default provision regarding the location of a corporation’s COMI (the place of registration), despite the

127. European Protocol concerning the interpretation by the Court of Justice of the Convention of 27 September 1968 on jurisdiction and the enforcement of judgments in civil and commercial matters, arts. 1–4, June 3, 1971, 1262 U.N.T.S. 259.

128. See Europa: European Union institutions and other bodies, The Court of Justice, http://europa.eu/institutions/inst/justice/index_en.htm (last visited Apr. 3, 2009) (providing an overview of the Court’s structure).

129. Case C-341/04, *In re Eurofood IFSC Ltd.*, 2006 E.C.R. I-03813, Judgment 1, para. 152, Judgment 2, para. 69.

130. Heribert Hirte, *Towards a Framework for the Regulation of Corporate Groups’ Insolvencies*, 5 EUR. COMPANY AND FIN. L. REV. 213, 214 (2008).

131. See *In re Eurofood IFSC Ltd.*, 2006 E.C.R. I-03813, Judgment 1, para. 41 (noting that failure to provide adequate notice amounted to lack of due process).

132. *In re Daisytek-ISA Ltd.*, [2003] B.C.C. 562, [2]–[3] (Ch.) (U.K.).

133. *Id.* at [16]–[18].

134. ROY GOODE, PRINCIPLES OF CORPORATE INSOLVENCY 589 (3d ed. 2005).

135. *Id.* at 590.

136. E.g., Irit Mevorach, *The “Home Country” of a Multinational Enterprise Group Facing Insolvency*, 57 INT’L & COMP. L.Q. 427, 444 (2008); Christoph G. Paulus, *The Aftermath of “Eurofood” — BenQ Holding BV and the Deficiencies of the ECJ Decision*, 20 INSOLVENCY INTELLIGENCE 85 (2007).

137. Case C-341/04, *In re Eurofood IFSC Ltd.*, 2006 E.C.R. I-03813, Judgment 1, para. 126.

continuing weakening of the presumption to this effect.¹³⁸ The approach in this case underlines the court's acceptance of the idea that the Regulation makes no special provision for enterprise groups. This must surely be seen as a retrograde step, at least by those who wish for progress towards centralizing, as far as possible, the insolvency process of a large multinational enterprise group. Perhaps the element of bad faith—the failure of the Italian insolvency administrator to give the Irish liquidator of Eurofoods sufficient time to answer the case before the court in Parma—will provide a basis for distinguishing this decision in the future.

III. CURRENT REFORM ACTIVITIES

The UN established the United Nations Commission on International Trade Law (UNCITRAL) in 1966 in express recognition of the disparities between national laws governing international trade and the extent to which these disparities create obstacles to the flow of trade.¹³⁹ UNCITRAL was thus established as a vehicle for exploring and, where appropriate, recommending changes in order to create greater harmony within the legal systems of the member-states in matters of international trade law.

It has made a huge contribution to the current attempts to harmonize bankruptcy procedures where the debtor's business stretched across international boundaries. In 1997, UNCITRAL completed and published the Model Law on Cross-Border Insolvency and Guide to Enactment.¹⁴⁰ The nature of a Model Law is that, while not binding in itself, nation states will implement it as far as possible in the form in which it was drafted, and thereby bring wide international legislative uniformity to its provisions. Some sixteen countries have implemented the Model Law on Cross Border Insolvency, including the United States, the U.K., Australia, New Zealand, South Africa, and Japan.¹⁴¹ It was followed by the adoption by UNCITRAL and the UN General Assembly in 2004 and the publication in 2005, of the Legislative Guide on Insolvency Law,¹⁴² which was designed to encourage member-states of the UN to adopt effective business insolvency regimes.¹⁴³

Both these initiatives are essentially concerned with traditional single debtor insolvency, but the Legislative Guide references the issue of group insolvency.¹⁴⁴ Moreover, the topic of Corporate Groups in Insolvency was referred to UNCITRAL's Insolvency Working Group (Working Group V), and the Working

138. *Id.*

139. Origin, Mandate and Composition of UNCITRAL, <http://www.uncitral.org/uncitral/en/about/origin.html> (last visited Apr. 5, 2009).

140. U.N. COMM'N ON INT'L TRADE LAW [UNCITRAL], UNCITRAL MODEL LAW ON CROSS-BORDER INSOLVENCY WITH GUIDE TO ENACTMENT, U.N. Sales No. E.99.V.3 (1997), available at http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency/1997Model.html.

141. U.N. Comm'n on Int'l Trade Law [UNCITRAL], Status: 1997 Model Law on Cross-Border Insolvency, http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency/1997Model_status.html (last visited Apr. 8, 2009).

142. U.N. COMM'N ON INT'L TRADE LAW [UNCITRAL], LEGISLATIVE GUIDE ON INSOLVENCY LAW preface (2005), U.N. Sales No. E.05.V.10 available at http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency/2004Guide.html.

143. *Id.* at iii.

144. *Id.* at 276–79.

Group is nearing the end of its discussions, following which it will publish its list of recommendations.¹⁴⁵

It is thus too early to say anything substantive about this initiative in the matter of the insolvency in enterprise groups. Nevertheless, it may be helpful to recite the initial sense with which the Working Group assumed the task—in effect, the mandate that the Working Group saw itself inheriting:

11. It was indicated that the structure of corporate groups could vary greatly and be especially intricate, in particular, in the case of transnational corporate groups.

Recent developments added further elements of complexity, for instance, in case of special forms of intra-group control, such as special purpose entities and joint ventures, as well as in the case of agreements for the temporary control of one company over another. It was added that economic activities, which were traditionally subject to a separate discipline, such as banking and insurance, were also increasingly performed in the context of corporate groups, thus adding an additional layer of complexity to their discipline.

12. It was confirmed that, while most jurisdictions refrained from offering a general definition of corporate groups, such definition often existed for special purposes, such as tax and accounting rules. In the insolvency field, the “separate entities approach” was prevalent, but certain instruments were available, under given conditions, to trigger the cross-liability of the companies belonging to the same corporate group.

13. In some jurisdictions that had recently reformed or attempted to reform their insolvency law to recognize the notion of corporate groups, it was observed that difficulties were encountered in the definition of that notion because of the need to achieve a balance between ensuring predictability and transparency and reflecting economic reality. It was suggested that reference to the notion of ownership, typically in terms of percentage of shares owned by the parent company, would provide a more certain basis for the definition of corporate groups. On the other hand, reference to the notion of control, while based on less objective parameters, would give more flexibility in addressing the diverse economic realities expressed by the operations of corporate groups.

14. The view was expressed that corporations served many important social, commercial and legal purposes. The provision of limited liability, in particular, facilitated the raising capital for business purposes, enabled creditors to rely on the assets and liabilities of the corporate entity with which they dealt, and provided certainty in commercial relations. It was noted that those purposes were baseline commercial and legal principles in many nations, and that to interrupt reliance and the expectations that arose from those principles would require some extraordinary rationale.

145. U.N. Comm'n on Int'l Trade Law [UNCITRAL], Working Group V (Insolvency Law), *Annotated Provisional Agenda for the Thirty-Sixth Session of Working Group V (Insolvency Law)*, Item 4, U.N. Doc. A/CN.9/WG.V/WP.84 (Feb. 23, 2009), available at http://www.uncitral.org/uncitral/en/commission/working_groups/5Insolvency.html.

It was further suggested that the circumstances for disregarding those principles rarely occurred.¹⁴⁶

As has already been mentioned, the Working Group changed the title of the concept from Corporate Groups to Enterprise Groups. Although it has divided its deliberations between Domestic and International issues,¹⁴⁷ there is a substantial overlap between these two categories. Some of the issues in which this overlap occurs include the COMI of the group, post-commencement financing, procedural coordination, substantive consolidation, the appointment of a single insolvency representative, the reorganization of two or more group members, the approval of a single reorganization plan, avoidance proceedings, and equitable subordination.¹⁴⁸

IV. CONCLUSION

Groups of companies have moved rapidly up the reform agenda. They have become matters of major public importance, and their supporters and detractors increasingly perceive them in confrontational terms. They have become of considerable interest to those interested in the anthropology and funding of the underdeveloped world, and they have attracted the attention of legal scholars from the company law and insolvency worlds, where they provide a complex extension of the issues, inter alia, of limited liability and the nature of corporate status. Insolvency, as is often the case, provides a hard, practical platform on which to examine many of these issues, since it is often during an insolvent liquidation when conflicting interests sharpen and the serious business of climbing up the hierarchy of creditors occurs. Corporate members are often creditors and sometimes even secured creditors, in the bankruptcy of an affiliate. And as secured creditors, they are, of course, capable of ousting the claims of outside creditors. Many perceive this as self-dealing in the interests of affiliated companies to the detriment of outside creditors. In part, this article has sought to describe some of the means by which courts and legislatures have attempted to eliminate any ensuing unfairness.

The approach of the UNCITRAL Working Group is cautious, as was clearly foreshadowed by its mandate. With regard to the issues on which it proposes to make recommendations, one may only say that the agenda is both long and hugely complex. Nevertheless, despite the often seemingly intractable nature of insolvency,¹⁴⁹ progress has been made. Given that insolvency touches on so many raw nerves and tensions in a society's regulation—treatment of employees, destruction or rescue of businesses, entrepreneurial initiative, loss of money by

146. U.N. Comm'n on Int'l Trade [UNCITRAL], Working Group V (Insolvency Law), *Introduction to the Report of Working Group V (Insolvency Law) on the Work of its Thirty-First Session (Vienna, 11–15 December 2006)*, paras. 11–14, U.N. Doc. A/CN.9/618 (Jan. 8, 2007), available at http://www.uncitral.org/uncitral/en/commission/working_groups/5Insolvency.html.

147. U.N. Comm'n on Int'l Trade [UNCITRAL], Working Group V (Insolvency Law), *Report of Working Group V (Insolvency Law) on the Work of its Thirty-Fifth Session (Vienna, 17–21 November 2008)*, paras. 23–41, U.N. Doc. A/CN.9/666 (Dec. 2, 2008), available at http://www.uncitral.org/uncitral/en/commission/working_groups/5Insolvency.html.

148. *Id.*

149. Deliberations and negotiations leading to the EU's Regulation on Insolvency Proceedings took nearly forty years! IAN F. FLETCHER, *INSOLVENCY IN PRIVATE INTERNATIONAL LAW: NATIONAL AND INTERNATIONAL APPROACHES* 246–55 (Oxford University Press 1999).

creditors, respective rights and obligations of debtors and creditors, tensions between different groups of creditors (secured, unsecured, preferential), and the role of management and the principles of governance—the fact that progress is slow is hardly surprising. And to this list we have now added the issue of enterprise group identity!

It would be remiss, however, not to record with admiration the enormous strides that the personnel who work within bankruptcy, especially international and cross-border bankruptcy, have made by their interest and zeal in seeking coordination and harmony wherever possible. This goes for the judges who now speak to each other across borders as never before, for the lawyers who see in this coordination the possibility of better returns for their clients, and for the national and international civil servants whose intelligent disinterest is a very important factor in this search for an extremely elusive quest.