

Oversight and Financing of Cross-Border Business Enterprise Group Insolvency Proceedings

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I. INTRODUCTION

Business insolvency is on the rise, made more complex because of the multinational nature of business structures and the global reach of their economic activities.¹ The financial distress of an auto manufacturer in the United States can

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1. See, e.g., Carter Dougherty, *Germany's Leader in Hot Seat Over G.M. Aid Request*, N.Y. TIMES, March 7, 2009, (forecasting the complexities of a potential GM insolvency, particularly on the company's German subsidiary), available at http://www.nytimes.com/2009/03/07/world/europe/07germany.html?_r=1&scp=4&sq=dougherty,%20marc%20h%209&st=cse; The Secretariat, U.N. Comm'n on Int'l Trade Law [UNCITRAL], Working Group V (Insolvency Law), *Treatment of Corporate Groups in Insolvency*, para. 4, U.N. Doc.

implicate its subsidiary parts firms in India and Korea, its related supply companies in Canada, its holding company in Germany, its special purpose financing vehicles in the United Kingdom, its debenture holders in Hong Kong, insurers in Bermuda, local sales outlets domestically and abroad, and the employees of all these related businesses. Businesses have frequently integrated their own financing and productive activities within a corporate group or business enterprise group with separate legal entities in each domestic jurisdiction and highly integrated capital and governance structures. When a business slides into financial distress, the very structure of these multinational business enterprise groups poses significant challenges for how to address the insolvency. The business is global, but the laws addressing insolvency are local.² The ability of that business to restructure to become viable again or to liquidate to satisfy creditors' claims is highly dependent on the ease with which the insolvency law regimes of multiple jurisdictions can facilitate a fair and timely resolution to the business' financial distress.

A number of international initiatives have facilitated cross-border recognition of insolvency proceedings. The United Nations Commission on International Trade Law (UNCITRAL) Model Law on Cross Border Insolvency, for example, is aimed at facilitating recognition of foreign insolvency proceedings, while still allowing domestic courts to retain considerable jurisdiction over domestic proceedings.³ Courts apply the principles of comity and cooperation in order to conduct an orderly resolution of the firm's financial distress, whether that resolution entails liquidation, reorganization, or some combination of the two strategies.⁴ Currently, fifteen countries have adopted the Model Law, including the United States in its adoption of Chapter 15 of the U.S. Bankruptcy Code.⁵ These initiatives have increased the facility with which business insolvency is addressed in an increasingly globalized world. However, to date, the Model Law does not address corporate or enterprise groups.⁶ UNCITRAL has been deliberating for two years on how to recognize and address enterprise group insolvency.⁷

A/CN.9/WG.V/WP.74/Add.2 (Oct. 4, 2006) [hereinafter *Treatment of Corporate Groups in Insolvency Add.2*].

2. See, e.g., Faye Knowles, *Insolvency in the Global Economy: "Bring Me Your Tired, Your Poor, Your Troubled Companies Yearning to Reorganize!"*, LEXISNEXIS MARTINDALE-HUBBELL (R) LEGAL ARTICLES, May 13, 2004 (chronicling the issues faced by multi-national insolvent companies).

3. Model Law on Cross-Border Insolvency of the United Nations Commission on International Trade Law, G.A. Res. 52/158, U.N. Doc. A/RES52/158 (Jan. 30, 1998) [hereinafter UNCITRAL Model Law]; U.N. Comm'n on Int'l Trade Law [UNCITRAL], Working Group V (Insolvency Law), *Report of Working Group V (Insolvency Law) on the Work of Its Thirty-Fifth Session (Vienna, 17–21 Nov. 2008)*, U.N. Doc. A/CN.9/666 (Dec. 2, 2008) [hereinafter UNCITRAL Working Group V].

4. 11 U.S.C. § 1509(b)(3) (2008); see, e.g., *In re Loewen Group Int'l, Inc.*, 344 B.R. 727, 728–730 (Bankr. D. Del. 2006) (ruling that the court will grant motion for abstention and referral to arbitration, following its previous ruling confirming Debtors' plan for reorganization, in the interest of justice).

5. The countries that have adopted the Model Law as of August 2008 are: Australia (2008); British Virgin Islands, overseas territory of the United Kingdom of Great Britain and Northern Ireland (2005); Colombia (2006); Eritrea (1998); Great Britain (2006); Japan (2000); Mexico (2000); Montenegro (2002); New Zealand (2006); Poland (2003); Republic of Korea (2006); Romania (2003); Serbia (2004); South Africa (2000); and the United States of America (2005). It has been enacted but not proclaimed in force yet in Canada (2009). U.N. Comm'n on Int'l Trade Law [UNCITRAL], *Draft UNCITRAL Notes on cooperation, communication and coordination in cross-border insolvency proceedings*, para.14, U.N. Doc. A/CN.9/WG.V/WP.83, (Sept. 2, 2008) [hereinafter *UNCITRAL Draft Notes*]; 11 U.S.C. Ch. 15 (2006) ("Chapter 15").

6. *Treatment of Corporate Groups in Insolvency Add.2*, *supra* note 1, para. 1.

7. UNCITRAL Working Group V, *supra* note 3.

An important aspect of cross-border cooperation is the court's recognition and oversight of proceedings, including approval of interim financing for the insolvent business group during the period that it is seeking the protection of court-administered proceedings to address the insolvency. Many multinational business enterprises, while comprised of multiple separate legal entities, are often governed centrally with their finances highly interwoven.⁸ On insolvency, creditors seek to realize their claims from the specific entity with which they have contracted. However, a myriad of problems arise in making those claims, for instance: assets against which creditors may have claims shifting to other entities within the business group, problems of jurisdiction for making and realizing claims, different priorities of claims in different jurisdictions, and challenges for continued operation of the business where there is a possibility for a viable workout.

This article discusses recent developments in cross-border enterprise group insolvencies, including access to proceedings, the role of court oversight, and the availability of financing of the business during the period that it is trying to resolve its financial distress. Cross-border cooperation is a critically important aspect of international insolvency law, and there are mechanisms that can facilitate that cooperation. Equally, however, there are risks to creditors, particularly smaller stakeholders—such as trade suppliers, employees, and contingent claimants—who may be prejudiced by the recognition of a consolidated insolvency proceeding in a jurisdiction remote from their own. This article begins to explore some of these issues, seeking to articulate broad principles that should be considered when business insolvency involves multiple entities in multiple jurisdictions. Part II briefly examines the nature of cross-border business enterprise groups, including financing and oversight challenges. Part III explores international cooperative efforts to address the insolvency of businesses that cross jurisdictions, including the divergence in tests recognizing center of main interests and the challenges that divergence may pose for business enterprise groups. Part IV examines the use of cross-border protocols in business enterprise group insolvency and explores the contours of procedural coordination and substantive consolidation of proceedings. Part V focuses more specifically on financing the insolvent business group during the proceedings and the principles that should apply. The term “insolvency” is used throughout, because it is the term used in most jurisdictions. However, it is important to note that some countries, such as the United States, use the term “bankruptcy” rather than insolvency.

II. THE CROSS-BORDER BUSINESS ENTERPRISE GROUP

Multinational business enterprise groups are comprised of corporations, partnerships, business trusts, unincorporated businesses, and other entities. The enterprise group may be highly integrated and operate as a global unit, or the entities in the group may operate relatively independently of one another such that they are truly separate legal entities. The governance and capital structure can be highly centralized, with a parent corporation or business entity wholly owning and largely controlling subsidiaries, as is often the case in the United States or Germany. The

8. See, e.g., Dougherty, *supra* note 1 (discussing how GM's financial issues threaten the existence of its German subsidiary Opel).

control can be held through a family structure or a group of related investors such that, while the entities are legally separate, there is considerable control exercised between the entities, as with a number of business enterprise groups in India, Canada, or parts of South America.⁹

Separate legal entities are often formed to manage assets and operations in each jurisdiction in which an MNE operates, as an efficient means of conducting economic activities. Separate legal entities can facilitate compliance with local regulatory and statutory requirements and reduce liability risk for the parent entity and related entities.¹⁰ The capital and governance structure may be designed as a pyramid with control at the top, or the structure may be the result of an aggregation of businesses acquired over an extended period. A business group may also have separate legal entities for financing purposes; for example, a debtor may utilize multiple special-purpose entities to place particular assets in a separate entity with the asset lender as the sole creditor; hence there are multiple entities, but highly integrated control and operations. The business enterprise group is a risk reduction strategy in the sense that claims against one entity for particular kinds of conduct in a jurisdiction will attach only to that legal entity, except in very limited circumstances where the courts consider drawing aside the corporate veil.¹¹

Business enterprise groups can create efficiencies through lateral integration with suppliers or retail outlets, or through new value from horizontal integration of businesses. Business groups may have grown their business through mergers or acquisitions rather than relying solely on the longer term process of investing in organic growth, yet the capital and governance could be highly integrated or very distinct. Where the business enterprise group is comprised of separate legal entities, the integration of financial systems and the co-mingling of supplies and common control can lead less sophisticated creditors into believing that they are dealing with an entity with a reputation that leads them to believe it is a good credit risk, when, in reality, their legal relationship is with a separate legal personality.¹²

Where the enterprise group is viable, its capital and governance structure is not problematic as the entities meet their credit obligations on a current basis. However, when one or more entities in the enterprise group become insolvent, creditors in each of the domestic jurisdictions in which business entities of an enterprise group are registered will seek to use domestic law to realize on their claims. Where companies in a business enterprise group operate independently and have few operational or financial links, other than a parent-subsidiary relationship, it may not pose a problem to deal with their insolvency as separate entities. However, where control, finances and operations are highly integrated within the business enterprise group, then

9. For a general discussion, see Janis Sarra, *Maidum's Challenge, Legal and Governance Issues in Dealing with Cross-Border Business Enterprise Group Insolvencies*, 17 INT'L INSOLVENCY REV. 73, 78 (2008) (discussing location of this type of capital structure); see also Randall Morck & Bernard Yeung, *Some Obstacles to Good Corporate Governance in Canada and How to Overcome Them*, in CANADA STEPS UP: MAINTAINING A COMPETITIVE CAPITAL MARKET IN CANADA 279, 295 (Task Force to Modernize Securities Legislation in Canada 2006) (observing that Canada, Latin America, and East Asia typically have a wealthy family, which holds voting control blocks in up to sixteen tiers of listed firms), available at http://www.tfmsl.ca/docs/Volume4_en.pdf. Morck and Yeung observe that Canada, Latin America and East Asia typically have a wealthy family, which holds voting control blocks in up to 16 tiers of listed firms.

10. Sarra, *supra* note 9, at 76.

11. *Id.*

12. *Id.* at 81.

insolvency proceedings in the separate jurisdictions can pose enormous problems, creating the risk of premature liquidation of the companies to satisfy multiple domestic claims in multiple jurisdictions. While there may be greater value with which to meet creditors' claims if the enterprise group was restructured and continued in operation, such an option may not be viable where domestic law leans towards liquidation rather than rescue. The separate nature of these entities may make it difficult to reorganize the business enterprise group as a whole, even when value might be better maximized for creditors through a global resolution of the firm's financial distress.

If liquidation of the insolvent enterprises is the objective, entities in a business enterprise group can be liquidated as separate entities such that creditors that made explicit contracts with the specific business entity should be able to rely on that separate legal personality to realize their claims. However, when the liquidation takes the form of a going concern sale, in which parts of the business enterprise group may be sufficiently integrated such that they are necessary to maximize sale value or perhaps necessary to the sale itself, treatment of creditor claims by a separate entity may lead to an overall diminution of return to creditors. Liquidation by entity may also fail to recognize how assets have been transferred between entities during the financially healthy years and disadvantage creditors that have claims against the entity that continually transferred its wealth to the parent, leaving few assets for the satisfaction of creditors' claims.

Employees who have worked to generate wealth for one entity may have claims against an entity with no assets, as the profits have been uploaded to the parent entity on a daily basis. In some jurisdictions, the courts will recognize that the corporate entity is really a single business enterprise, and ensure that employee claims are met. In others, the separate legal personality protects the debtor entities from creditors. Hence, there is a question of fairness in terms of how one protects the notion of the separate legal personality while creating a fair and effective insolvency system that recognizes the residual interests of creditors.

A parent corporation can have a subsidiary in another country that is absolutely vital to the worldwide organization, but if the parent cannot get coordination across jurisdictions, there is no maximization of value. In such cases, commercial reality suggests that there must be, at minimum, coordination of multiple insolvency proceedings. Different juridical frameworks may pose difficulties for cross-border resolution of highly integrated group insolvencies. Some common law jurisdictions require a pre-condition of insolvency before an entity can file proceedings, which can be problematic where some related entities are insolvent and others are not. In civil law jurisdictions, the civilist legal tradition suggests that, absent express statutory language setting out a framework for dealing with cross-border enterprise group insolvency, the courts do not have authority over such groups.

Proceedings with respect to related entities in a business group are frequently commenced concurrently in multiple jurisdictions, although such proceedings may or may not advance a global resolution of the debtors' insolvency, particularly where regimes differ as to their liquidation or rehabilitation goals, or where procedures for resolving the firm's financial distress vary considerably. In a cross-border proceeding, the facility with which a business enterprise group will be able to

restructure will depend to a large measure on the courts' willingness to grant relief that facilitates the restructuring but is not inconsistent with domestic legislation.¹³ Given that different regimes internationally have different normative conceptions of insolvency, with particular focus on rehabilitation or liquidation or a mix of both, the ability to restructure as a business enterprise group may be hampered if the courts narrowly interpret their authority.¹⁴

III. INTERNATIONAL ALIGNING OF APPROACHES TO BUSINESS INSOLVENCY LAW

Globally, insolvency systems are beginning to align in their recognition that mature insolvency law systems require two avenues for addressing business financial distress. The first, liquidation, allows the efficient gathering in of the assets of the bankrupt estate and distribution of the value to creditors, based on the specific priority of claims set out in the relevant insolvency statute. The second objective is to offer reorganization or restructuring as a potential option for resolution of the financial distress, where the insolvent business negotiates a plan with creditors that involves a compromise of debt or some other arrangement that allows the business the opportunity to become viable again.¹⁵ It is critically important to have transparency and certainty in whatever system a jurisdiction adopts. Transparency is important so that parties can ascertain and act on their rights, and certainty is important so that creditors can price their risk, confident of how their claims will be dealt with in the event that the business becomes insolvent.

Yet while there is growing consensus on the need for both liquidation and reorganization components of the insolvency law system, jurisdictions differ considerably on key aspects, such as: whether directors and officers are allowed to continue controlling the business during the insolvency proceeding, the availability of post-commencement financing, the priority accorded to particular creditors, and the extent to which secured creditors' remedies are stayed during a reorganization proceeding. These differences pose a serious challenge for business enterprise groups that may be confronted with very different structures in each jurisdiction in which the business operates. If the business is highly integrated, the different systems could work to defeat a global resolution of the group's insolvency.

The number of cross-border insolvency cases has increased significantly in the past two decades. Yet domestic and international insolvency law systems have often not been responsive to the growing need to deal with the complexity of such cases, resulting in unfair, inefficient, and uncoordinated proceedings that can harm the ability of otherwise viable business entities to devise new business plans that

13. *Id.* at 90.

14. Sarra, *supra* note 9, at 90–91.

15. UNCITRAL defines reorganization as “the process by which the financial well-being and viability of a debtor’s business can be restored and the business continue to operate, using various means possibly including debt forgiveness, debt rescheduling, debt equity conversions and sale of the business (or parts of it) as a going concern.” U.N. COMM’N ON INT’L TRADE LAW (UNCITRAL), LEGISLATIVE GUIDE ON INSOLVENCY LAW 7, U.N. Sales No. E.05.V.10 (2005) [hereinafter UNCITRAL LEGISLATIVE GUIDE], available at http://www.uncitral.org/pdf/english/texts/insolven/05-80722_Ebook.pdf.

maximize value, lower return to creditors, retain employees, and increase economic activity.

While historically many jurisdictions were highly territorialistic in their approach to insolvency proceedings, there is increasingly a move towards what has been called modified universalism.¹⁶ The notion of modified universalism, advanced by the Model Law, is court recognition of main proceedings in one jurisdiction and non-main proceedings in other jurisdictions, representing some compromise of state sovereignty under domestic proceedings to advance international comity and cooperation.¹⁷ In addition to the Model Law, there are a number of international cooperative efforts, including: the UNCITRAL *Legislative Guide on Insolvency Law*, aimed at assisting jurisdictions that are trying to develop insolvency law regimes; the American Law Institute's *Guidelines Applicable to Court-to-Court Communications in Cross-Border Cases*, aimed at encouraging cooperation in international cases;¹⁸ the European Council Regulation on insolvency proceedings, aimed at coordination of insolvency proceedings within the EU;¹⁹ and the European Communication and Cooperation Guidelines for Cross-Border Insolvency, aimed at enhancing cooperation in cross-border cases.²⁰

The UNCITRAL Model Law offers a legislative framework to facilitate cooperation and coordination in cross-border cases with a view to promoting greater legal certainty for trade and investment, fair and efficient administration of cross-border insolvencies that protects the interests of creditors and other interested persons, protection and maximization of the value of the debtor's assets, and facilitation of the rescue of financially troubled businesses, in turn protecting investment and preserving employment.²¹ In adopting the UNCITRAL Model Law and recommending that states adopt it domestically, the United Nations General Assembly observed that increased cross-border trade and investment has led to an urgent need for cross-border cooperation to facilitate the supervision and administration of the insolvent debtor's assets and affairs in order to prevent loss of viable businesses, inefficiencies in administration of cross-border insolvencies, and loss of debtor's assets being concealed or dissipated.²²

The Model Law establishes simplified procedures for recognition of foreign proceedings, sets out the consequences of recognition, provides a transparent regime for the right of foreign creditors to commence or participate in an insolvency proceeding in another state, permits courts and insolvency representatives to cooperate more effectively with foreign courts and foreign representatives involved in an insolvency matter and coordinate proceedings, authorizes persons administering insolvency proceedings in the enacting State to seek assistance abroad,

16. Jay Westbrook, *Universalism and Choice of Law*, 23 PENN ST. INT'L L. REV. 625, 625 (2005).

17. *Id.* at 626.

18. GUIDELINES APPLICABLE TO COURT-TO-COURT COMMUNICATIONS IN CROSS-BORDER CASES (2000), available at <http://www.ali.org/doc/Guidelines.pdf>.

19. Council Regulation 1346/2000, 2000 O.J. (L 160) (EC).

20. BOB WESSELS & MIQUEL VIRGES, EUROPEAN COMMUNICATION AND COOPERATION GUIDELINES FOR CROSS-BORDER INSOLVENCY (2007).

21. UNCITRAL Working Group V, *supra* note 3, at 11, (noting that an intergovernmental working group, including representatives of seventy-two States, seven intergovernmental organizations, and ten non-governmental organizations, negotiated the UNCITRAL Model Law between 1995 and 1997).

22. G.A. Res. 52/158, U.N. Doc. A/RES/52/158 (Jan. 30, 1998).

and establishes rules for coordination of relief.²³ The Model Law authorizes direct communication between courts, insolvency representatives, and creditors; allowing parties to exchange material information, including judgments, local rules, and evidence.²⁴ It offers a mechanism for those with an economic interest in the insolvent business to understand the requirements of the respective laws and their scope and application, to assist with the resolution of disputes on a timely basis through negotiation or timely litigation, and to discuss possible strategies for going forward.²⁵

The conduct of cross-border insolvency proceedings will often require assets of the different insolvency estates to continue to be used, realized, or disposed of in the course of the proceedings, and the UNCITRAL Model Law assists in providing a framework to protect the interests of all parties. Coordination may include determining the law governing the assets and the parties responsible for determining how they can be used or disposed of and the approvals required, the extent to which responsibility for those assets can be shared among or allocated to those different parties in different States, and how information can be shared to ensure coordination and cooperation.²⁶ As noted in the introduction, the Model Law does not address the insolvency of business groups operating in multiple jurisdictions.²⁷ UNCITRAL's current working definition of business enterprise group is "two or more enterprises that are interconnected by control or [significant] ownership."²⁸ The purpose of the current UNCITRAL deliberations is to consider under what circumstances a joint application for commencement of insolvency proceedings should be made to facilitate coordination of members of an enterprise group, and increase efficiency, and reduce costs of the proceedings.²⁹

Under the existing cross-border instruments, the notion of center of main interests has been used to determine where proceedings should be commenced and which jurisdiction should have principal oversight of the restructuring or liquidation proceedings. The concept is complicated for treatment of business enterprise groups.

23. In the *Maxwell* case, for example, the U.S. court appointed an examiner with expanded powers under Chapter 11 of the U.S. Bankruptcy Code to facilitate coordination of the different proceedings. *In re Maxwell Comm. Corp.*, Case no. 91 B15741 (Bankr. S.D.N.Y. 1992). In the *Nakash* case, an examiner was also appointed by the US court to attempt to develop a protocol for harmonizing and coordinating the Chapter 11 proceedings with certain proceedings taking place in Israel. *In re Nakash*, 190 B.R. 763 (Bankr. S.D.N.Y. 1996). In *Matlack*, cross-border agreement provided for the intermediary to periodically or upon request deliver to the court reports summarizing the status of the foreign insolvency proceedings and such other information as the court might order. *In re Matlack Inc.* (2001) 26 C.B.R. (4th) 45 (Ont. S.C.J.).

24. UNCITRAL Model Law, *supra* note 3, arts. 25–26.

25. *Id.*

26. UNCITRAL Model Law, *supra* note 3, art. 30.

27. *Treatment of Corporate Groups in Insolvency Add.2*, *supra* note 1, para. 1.

28. UNCITRAL LEGISLATIVE GUIDE, *supra* note 15; UNCITRAL Working Group V, *supra* note 3, para. 49; U.N. Comm'n on Int'l Trade Law [UNCITRAL], Working Group V (Insolvency Law), *Report of Working Group V (Insolvency Law) on the Work of Its Thirty-Fourth Session (New York, 3–7 Mar. 2008)*, U.N. Docs A/CN.9/647 (Mar. 14, 2008) para. 16.

29. U.N. Comm'n on Int'l Trade Law [UNCITRAL], Working Group V (Insolvency Law), *Report of Working Group V (Insolvency Law) on the Work of Its Thirty-First Session (Vienna, 11–15 Dec. 2006)*, U.N. Doc. A/CN.9/618 (Jan. 8, 2007) para. 19.

IV. TEST FOR RECOGNITION, THE CENTER OF MAIN INTERESTS

The Model Law adopts the concept of center of main interests (COMI) as the mechanism for determining main and non-main proceedings.³⁰ COMI is significant for considering treatment of business enterprise groups because it may determine whether courts will recognize a highly integrated business enterprise group as coming within the definition of COMI. COMI is not defined in the statutes. The UNCITRAL Legislative Guide on Insolvency Law defines centre of main interest as “the place where the debtor conducts the administration of its interests on a regular basis and that is therefore ascertainable by third parties.”³¹ A debtor must have a sufficient connection to a state to be subject to its insolvency laws.³² The practical effect is that a corporate entity can be registered in one jurisdiction but have its COMI elsewhere. Arguably, COMI could also be located within one entity of a business enterprise group even though registration of the entities in the business enterprise group is in a number of jurisdictions.

While the concept of COMI is a useful one, the courts have diverged in their approach to COMI, with the EU offering one framework and countries such as the United States and Canada offering another, posing problems for recognition of business enterprise groups.³³ The EU and U.S./Canadian approaches are briefly compared below.

In the EU, COMI is the criterion for opening proceedings under the EC Regulation on Insolvency Proceedings, although it is aimed at different purposes than the Model Law provisions.³⁴ The EC Regulation is binding on EU Member States, and the regulation’s provisions take precedence over any conflicting provisions of any Member’s national insolvency law.³⁵ A finding of COMI in one Member State extends the reach of that state’s insolvency law to assets located throughout the EU.³⁶ The EC Regulation restricts its application to collective

30. See also Office of the Superintendent of Bankruptcy Canada, *Crossing the Finish Line: the Potential Impact on Business Rescue of Adoption of new Cross-Border Insolvency Provisions—Part 2: Part II: Chapter 47 Provisions as Compared with the Model Law and Chapter 15 of the U.S. Bankruptcy Code*, Heading 2, Dec. 4, 2008, available at <http://www.ic.gc.ca/eic/site/bsf-osb.nsf/eng/br02022.html>; Look Chan Ho, *Proving COMI: Seeking Recognition Under Chapter 15 of the US Bankruptcy Code*, J. OF INT’L BANKING L. & REG. 636, 636 (2007). See generally UNCITRAL LEGISLATIVE GUIDE, *supra* note 21.

31. UNCITRAL LEGISLATIVE GUIDE, *supra* note 15, at 4, 41, (citing Council Regulation 1346/2000, 2000 O.J. (L 160) (EC). The guide is aimed at establishing an effective insolvency framework).

32. Office of the Superintendent of Bankruptcy Canada, *supra* note 36; UNCITRAL LEGISLATIVE GUIDE, *supra* note 21, at 41 (2005).

33. Office of the Superintendent of Bankruptcy Canada, *supra* note 36.

34. Council Regulation 1346/2000, Recital 14, 2000 O.J. (L 160) 2 (EC). The EC Regulation is subordinate legislation under the *Treaty Establishing the European Community* and is binding in its entirety on, and has general and direct applicability in, all Member States except Denmark, a total of 24 countries, EC *Treaty Establishing the European Community* (Consolidated Version 2002), [2002] O.J. C 325/33 [hereinafter EC Treaty]; IAN F. FLETCHER, *INSOLVENCY IN PRIVATE INTERNATIONAL LAW*, (2005), paras. 7.24, 7.27.

35. It is binding under the doctrine of supremacy of EC law over national law. The European Court of Justice has the authority to determine conflicts arising out of different interpretive approaches to the Regulation among the Member States, serving as the final appellate court for the Member States of the EU for the purpose of determining questions of the validity of the EC Regulation and its interpretation; *Consolidated EC Treaty of 1999*, arts. 220, 234, (Mar. 25, 1957), available at http://eur-lex.europa.eu/en/treaties/dat/12002E/htm/C_2002325EN.003301.html.

36. Council Regulation 1346/2000, Recital 12, 2000 O.J. (L 160) 2 (EC).

insolvency proceedings that involve partial or total divestment of a debtor and the appointment of a liquidator.³⁷ Hence, the Regulation excludes insolvency proceedings that leave the debtor in full control of its estate and business.³⁸ Although partial divestment allows the debtor to come within the ambit of the Regulation, there must be some degree of loss of the debtor's powers of administration and control over the business and assets.

The EC Regulation utilizes COMI to determine where main proceedings should be commenced within the EU. It does not define COMI, but Article 3 of the Regulation creates a rebuttable presumption that the registered office of a debtor company is the center of its main interests in the absence of proof to the contrary.³⁹ The principle underlying the rebuttable presumption is that creditors are entitled to certainty in their dealings with debtor companies and they should be able to make assessments of their risks of transacting with the debtor based on transparency in respect of which jurisdiction's laws would apply in the event of insolvency.⁴⁰ Under the EC Regulation, if a proceeding is qualified as a main proceeding, the proceeding benefits from full extra-territorial effects, binding all Member States under the Regulation and encompassing the debtor's assets globally.⁴¹ Recital 13 of the Regulation states that the term COMI should correspond to "the place where the debtor conducts the administration of [its] interests on a regular basis and is therefore ascertainable by third parties."⁴² The Regulation applies only to proceedings where the center of the debtor's main interests is located in the European Community, not where its COMI lies elsewhere but there are non-COMI entities within the EC.⁴³ The EC Regulation specifies that proceedings commenced where a debtor has an establishment are secondary proceedings where there is already a main proceeding opened.⁴⁴ The Regulation defines establishment as "any place of operations where the debtor carries out a non-transitory economic activity with human means and goods."⁴⁵

The *lex concursus*, the law of the Member State of the opening of the main proceeding, applies to all of the debtor's property, wherever situated, except to the

37. *Id.* art. 1.

38. Miguel Virgos & Etienne Schmit, *Report on the Convention on Insolvency Proceedings*, para. 9 (May 3, 1996), available at: http://aei.pitt.edu/952/01/insolvency_report_schmidt_1988.pdf.

39. Council Regulation 1346/2000, art. 3, 2000 O.J. (L 160) (EC).

40. *See Id.* art. 3 (stating the rules for determining the jurisdiction over insolvency proceedings of a debtor that has assets in multiple States).

41. *Id.*

42. Council Regulation 1346/2000, Recital 13, 2000 O.J. (L160) 2 (EC).

43. *Id.*, Recital 14. The Regulation further specifies that "[p]rior to the opening of the main insolvency proceedings, the right to request the opening of insolvency proceedings in the Member State where the debtor has an establishment should be limited to local creditors and creditors of the local establishment or to cases where main proceedings cannot be opened under the law of the Member State where the debtor has the centre of its main interests." *Id.*, Recital 17.

44. However, the court of a Member State can open a proceeding prior to a main proceeding commencing where the debtor has its COMI, called independent territorial proceedings. If main proceedings are subsequently opened, the territorial proceedings then become secondary proceedings, restricted to liquidation of those assets of the debtor situated in the particular State. *Id.*

45. *Id.* art. 2(h). *See also id.*, art. 26 which contains a narrow public policy exception, in that "[a]ny Member State may refuse to recognize insolvency proceedings opened in another Member State or to enforce a judgment handed down in the context of such proceedings where the effects of such recognition or enforcement would be manifestly contrary to that State's public policy, in particular, its fundamental principles or the constitutional rights and liberties of the individual."

extent that secondary proceedings have been opened.⁴⁶ The law of the State of the main proceedings determines the conditions for the opening, conduct, and closure of proceedings, including specified substantive and procedural matters.⁴⁷ Where secondary insolvency proceedings are opened, the law applicable to the secondary proceedings is that of the Member State within which the secondary proceedings are opened, and the secondary proceedings are restricted to the assets of the debtor situated in that Member State.⁴⁸

While the EU case law was initially unsettled, the European Court of Justice (Grand Chamber) interpreted COMI in *Eurofood IFSC Ltd.* in a judgment rendered in May 2006, the first EC appellate decision on COMI.⁴⁹ The judgment set out principles for determination of COMI. The ECJ ruled that where a debtor is a subsidiary company whose registered office and that of its parent company are situated in two different Member States, the presumption laid down in Article 3 of the Regulation that “the centre of main interests of that subsidiary is situated in the Member State where its registered office is situated, can be rebutted only if factors that are both objective and ascertainable by third parties enable it to be established that an actual situation exists that is different from the registered office is deemed to reflect.”⁵⁰ It held that in the system established by the Regulation, “for determining the competence of the courts of the Member States, each debtor constituting a distinct legal entity is subject to its own court jurisdiction,” and the Regulation must “be interpreted in a uniform way independently of national legislation.”⁵¹ The Court held that the presumption could be rebutted where a company is not carrying out any business in the territory of the Member State where its registered office is situated, but the mere fact that its economic decision making is controlled or could be controlled by a parent company in another Member State is not enough to rebut the regulatory presumption.⁵² The Court further held that a main insolvency proceeding opened by a court of a Member State must be recognized by the courts of the other Member States without the latter being able to review the jurisdiction of the court of the opening State.⁵³ The court of a Member State may “refuse to recognize insolvency proceedings opened in another Member State only where the decision to open the proceedings was taken in flagrant breach of the fundamental right to be heard, which a person concerned by such proceedings enjoys.”⁵⁴

46. *Id.* at Recitals 23 and 25.

47. *Id.* art. 4(2)(a)-(m).

48. *Id.* arts. 3(2), 27, and 28.

49. Case C-341/04, *Eurofood IFSC Ltd – Enrico Bondi v. Bank of America, N.A.*, 2006 E.C.R. 3813; *Eurofood IFSC Ltd.*, Judgment of the European Court of Justice (Grand Chamber) (May 2, 2006), Europe Case C-341/04 [2004] O.J. C 251/7 <http://eur-lex.europa.eu>. Eurofood was registered in Ireland in 1997, with its registered office in Dublin. It is a wholly owned subsidiary of Parmalat SpA, registered in Italy. In the matter of *Eurofood IFSC Ltd.* and in the matter of the Companies Act 1963 to 2003, Enrico Bondi against Bank of America N.A., Pearse Farrell (the Official Liquidator), Director of Corporate Enforcement and the Certificate/Note holders, E.C.J. C-341/04, 2006 ECJ CELEX LEXIS 199 (Lexis).

50. Case C-341/04, *Eurofood IFSC Ltd.*, para. 37.

51. *Id.* paras. 30–31.

52. *Id.* paras. 34–36.

53. *Id.* paras. 39–40.

54. *Id.* para. 67.

The ECJ criteria were followed in *BenQ Mobile GmbH & Co.* in proceedings before the Munich and Amsterdam courts.⁵⁵ The Amsterdam Court held that “only if no or hardly any activities are performed in the country of the registered office according to the articles of association, the assumption that the COMI is situated in that location can be negated,” expressly declining to adopt a corporate group command and control analysis.⁵⁶ The judgments in *BenQ* indicate a high degree of deference to the first finding of COMI and main proceeding, as directed by the ECJ. The courts recognized local creditor interests and the need for certainty in terms of creditors’ reliance on the COMI of the debtor.⁵⁷

The ECJ approach may pose a problem for going concern solutions for business enterprise groups, as it rejects a “command and control” approach to assessing COMI, instead setting a high threshold to rebut the presumption.⁵⁸ Where members of a business enterprise group have registered offices and conduct business in different Member States, they are likely to be subject to multiple insolvency proceedings, creating a barrier to a global workout strategy even where the business group is highly integrated in its capital and governance structure. Given that secondary proceedings are restricted to liquidation proceedings in a Member State, absent coordination and co-operation, value may not be maximized through the separate realization of assets in secondary proceedings. However, it is important to note again that the scope of the EU Regulation means that it applies only where the debtor’s officers are no longer in control and where the COMI is in the EU.⁵⁹ Arguably, a “command and control” test may be used in other contexts; however, the EU courts may transport the ECJ approach into consideration of all applications for cross-border recognition.⁶⁰

The ECJ ruling represents a divergence from the reasoning of U.S. and Canadian courts, which have adopted more of a “command and control” test in discerning where the COMI is located. The U.S. Bankruptcy Code provides that a foreign proceeding for which Chapter 15 recognition is sought must be recognized as a foreign main proceeding if it is pending in the country where the debtor has the

55. *BenQ Mobile GmbH & Co. OHG [a trading partnership]* and *BenQ Mobile Holding B.V.*, Docket No. 1503 IE 4371/06 Munich, (Feb. 5, 2007).

56. *Id.*

57. *Id.*

58. Case C-341/04, *Eurofood IFCS Ltd.*

59. Council Regulation, *supra* note 36, art. 1.

60. Prior to the ECJ decision in *Eurofood IFCS Ltd.*, European courts had considered the following factors in rebutting the presumption that the COMI is located in the jurisdiction in which the debtor is registered: management and policy decision-making; financial arrangements between parent and subsidiary, including capitalization; the extent of a subsidiary’s independence with respect to financial decisions; the location of bank accounts and accountancy services; the division of responsibility with respect to provision of technical and legal documentation and signature of contracts; where design, marketing, pricing and delivery of products was conducted; and conduct of office functions. These considerations have been altered with the ECJ judgment, but they may provide some assistance in thinking about criteria for business enterprise groups where the EU regulation does not apply. *See, e.g.*, *Re Daisytek-ISA Ltd.*, [2003] B.C.C. 562 (Ch., Leeds) (U.K.); *Re BRAC Rent-A-Car International Inc* (2003) B.C.C. 248 (Ch.) (U.K.); *Collins & Aikman Corp.* (2005) B.C.C. 606, para. 38, (Ch.) (U.K.). *See, e.g.*, *Re Daisytek-ISA Ltd.*, and others, claim nos. 861–876 of 2003 [2003] BCC 562; [2004] B.P.I.R. 30 (Chancery Division, Leeds District Registry); *Hettlage-Austria*, Munich District Court, May 4, 2004, AG Munchen, *Beschl. V.4.5.2004-1501 IE 1276/04*; *Re BRAC Budget Rent-a-Car Int’l Inc.*, [2003] EWHC 128 (Ch) (Eng.). *Collins & Aikman Corp. Group*, [2005] EWHC (Ch) 1754, para. 38, (Eng.).

center of its main interests.⁶¹ There have been a number of recognition decisions.⁶² In *Muscletech Research and Development Inc.*, the U.S. and Canadian courts agreed that Canada was the COMI, using the indicia of place of registration, place of decision-making, financial control and banking, and administrative and operational factors.⁶³ In granting the Chapter 15 petition in *Muscletech* and granting the Ontario monitor's request to recognize and enforce a Canadian order setting out the claims procedure, Judge Rakoff held that the fact that most of the debtor's products were sold in the United States and that it had been subject to product liability litigation did not alter where the COMI was located.⁶⁴ The judgment indicated the court's willingness to endorse a cross-border legal system that does not completely align, but which provides due process.⁶⁵

In *re SPhinX Ltd.*, the U.S. Bankruptcy Court, Southern District of New York, recognized a foreign proceeding and granted the foreign representative status, but declined to recognize the Cayman Islands proceeding as a foreign main proceeding, using command and control criteria.⁶⁶ The Court in *re SPhinX Ltd.* held that it was

61. 11 U.S.C. § 1517 (2009).

62. 11 U.S.C. § 1517(b)(1). *9165-7999 Québec Inc.*, aka les Productions Sky High Vikings Inc., Bankr. N.D. Ill. Chapter 15 Recognition Order (Aug. 22, 2006), 06B-07875 recognizing a proceeding before the Québec Superior Court, the COMI was in Canada and that it was a foreign main proceeding pursuant to §1502(4) and entitled to recognition pursuant to §1517(b)(1) and relief under §1520; *Creative Building Maintenance Inc (Ontario) and Creative Building Maintenance Inc.(Delaware)*, Bankr. W.D.N.Y., Case 06-03587, Chapter 15 Order directing joint administration of related cases, recognizing the interim receiver in a proceeding before the Ontario Superior Court of Justice under the BIA, Nov. 21, 2006; In re: *Norshield Asset Management (Canada), Ltd.*, a/k/a *Norshield Financial Group; Norshield Investment Partners Holdings Ltd.*; *Olympus United Fund Holdings Corporation*, a/k/a *First Horizon Holdings Ltd.*; Order recognizing court-appointed receivership as a Foreign Main Proceeding with Canadian insolvency proceedings pending in the Ontario Superior Court of Justice (Commercial List) and the Québec Superior Court (Commercial Division), Bankr. D. Minn., BKY 06-40997 (June 28, 2006) pursuant to 11 U.S.C. § 1515; In re: *Mount Real Corporation*, Order recognizing MRACS Management Ltd., Foreign Main Proceeding, a/k/a *Mount Real Acceptance Corporation*; *Real Vest Investment Ltd.*; BKY 06-41636 *Real Assurance Acceptance Corporation*, a/k/a *Mount Real Assurance Acceptance Corporation*, Chapter 15 Recognition Order, Bankr. D. Minn., BKY 06-41636, (Sept. 6, 2006).

63. *Re Muscletech Research and Development Inc.*, [2006] O.J. No. 167 (Ont. S.C.J) para. 4 and *Re Muscletech Research and Development Inc.*, [2006] O.J. No. 462 (Ont. S.C.J.); In re *Ephedra Products Liability Litigation*, In re *Muscletech Research and Development*, Order of Judge Rakoff, 04 MD 1598, 06 Civ. 538 (S.D.N.Y.).

64. *In re Ephedra Products Liability Litigation, In re Muscletech Research and Development*, Order of Judge Rakoff.

65. *See In re Ephedra Products Liability Litigation*, 349 B.R. 333 (S.D.N.Y. Aug. 11, 2006) (holding that "Canadian court's order was entitled to recognition and enforcement"). "This was the first case in which the court considered the meaning of the 'manifestly contrary to public policy' exception in Chapter 15 of the U.S. Bankruptcy Code." OFFICE OF THE SUPERINTENDENT OF BANKRUPTCY CANADA CROSSING THE FINISH LINE: THE POTENTIAL IMPACT ON BUSINESS RESCUE OF ADOPTION OF NEW CROSS-BORDER INSOLVENCY PROVISIONS—PART 3, available at <http://www.ic.gc.ca/eic/site/bsf-osb.nsf/eng/br02023.html>. "The Court held that Congress made clear that the provision was to be interpreted narrowly, restricting the public policy exception to the most fundamental policies of the U.S." *Id.* "The Court held that while the constitutional right to a jury is an important component of the U.S. legal system, 'the notion that a fair and impartial verdict cannot be rendered in the absence of a jury trial defies the experience of most of the civilized world' and that it was difficult to detect what unfairness a plaintiff would suffer from having a civil case decided by a judge rather than a jury." *Id.* "The Court held that the claims procedure was fair and impartial and that nothing more is required by § 1506 or any other law." *Id.*

66. *Re SPhinX Ltd.*, Case No. 06-11760 (Bankr. S.D.N.Y. 2006).

appropriate to recognize a foreign non-main proceeding, even though there was no foreign main proceeding yet recognized in another jurisdiction. The court preferred this option to declining or deferring any recognition, as there were competent joint official liquidators under the supervision of the Cayman court.⁶⁷ Significantly, the Court failed to address the requirement of an “establishment” in the foreign jurisdiction in order to come within the definition of foreign non-main proceeding under section 1502(5) of the U.S. Bankruptcy Code, a problem identified in later judgments.

In *Bear Stearns*, Judge Lifland held that “the presumption that the place of the registered office is also the center of the debtor’s main interest is included for speed and convenience of proof where there is no serious controversy.”⁶⁸ Judge Lifland held that the various factors relevant to determination of COMI are the location of the debtor’s headquarters, the location of those who actually manage the debtor, the location of the debtor’s primary assets, the location of the majority of the debtor’s creditors or of a majority of the creditors that would be affected by the case, or the jurisdiction whose law would apply to most disputes.⁶⁹ Using a “command and control” analysis, the Court held that the COMI was the United States.⁷⁰ The decision was affirmed on appeal, the appellate court reciting the bankruptcy court’s listing of potential factors that could be relevant to a COMI determination.⁷¹ Aside from being registered in the Cayman Islands, the appellate court had found that the Funds had no other substantial connection with that country and denied recognition because the Funds existed in the Caymans as merely shells or letterbox companies.⁷²

Most recently, in *Betcorp Limited*, Judge Bruce Markell applied a “command and control” analysis to determining COMI.⁷³ “An Australian liquidator [sought] recognition under Chapter 15 of the Bankruptcy Code for the ongoing winding up and liquidation, in Australia, of Betcorp Limited, an Australian company.”⁷⁴ The court held that “a commonality of cases analyzing debtors’ COMI demonstrates that

67. *Id.* The Court also decided that the recognition petition was improper; specifically, that the debtors were seeking recognition of a foreign main proceeding in part to gain access to the automatic stay and thereby frustrate a settlement that one of the debtor’s largest creditors had received in another U.S. proceeding. *Id.*

68. *In re Bear Stearns High-Grade Structured Credit Strategies Master Fund*, Case No. 07-12383 (Bankr. S.D.N.Y. 2007) (denying recognition of a foreign proceeding to joint provisional liquidators of Bear Stearns High-Grade Structured Credit Strategies Master Fund and related funds pursuant to Chapter 15, and declining to recognize proceedings in the Grand Court of the Cayman Islands as foreign main proceedings or as foreign non-main proceedings).

69. *Id.* Judge Lifland rejected the notion that a court should make the recognition order because no objections had been filed and the Funds’ registered offices are in the Cayman Islands. The Court held that the petitioners’ own verified petitions provided the evidence to establish that the Funds’ COMI was in the United States, not the Cayman Islands. *Id.*

70. *Id.* at 130–32 (holding that the presumption had been rebutted, the Court also refused to grant recognition, as a foreign non-main proceeding as there was no establishment in the Cayman Islands. It held that “[n]on-recognition of the foreign proceedings, however, did not leave the Petitioners without the ability to obtain relief from U.S. courts” as “Section 303(b)(4) of the Bankruptcy Code specifically provides that an involuntary case may be commenced under chapter 7 or 11 of the Bankruptcy Code by a foreign representative of the estate in a foreign proceeding so that a foreign representative is not left remediless on non-recognition.”).

71. *In re Bear Stearns High-Grade Structured Credit Strategies Master Fund, Ltd.*, 389 B.R. 325, 336 (S.D.N.Y. 2008).

72. *Id.* at 338–39.

73. *In re Betcorp Ltd.*, 400 B.R. at 290.

74. *Id.* at 271.

courts do not apply any rigid formula or consistently find one factor dispositive; instead, courts analyze a variety of factors to discern objectively where a particular debtor has its principal place of business.”⁷⁵ Judge Markell observed that “this inquiry examines the debtor’s administration, management, and operations, along with whether reasonable and ordinary third parties can discern or perceive where the debtor is conducting these various functions.”⁷⁶ Based on these criteria, the petition for recognition as a foreign main proceeding was granted.

The significance of the U.S. and Canadian approach to COMI for determining business enterprise groups is that where operations of a business enterprise group are highly integrated and centralized in the jurisdiction of one entity, for example the parent corporation, U.S. and Canadian courts may find that the COMI of the other entities is in the same jurisdiction as the parent or other controlling entity such that they may recognize administrative coordination or consolidation.

The divergence in the tests applied by different courts raises significant challenges for future cross-border insolvency cases involving business enterprise groups, particularly those groups with entities in both North America and the EU. There are cases in which the business enterprise group should be reorganized as one proceeding, but definitions of COMI may not easily facilitate such a proceeding. Hence, the issue is whether COMI can be defined in particular circumstances to allow members of a business enterprise group to all have their COMI in one state, even where their registered offices are in different states and there is economic activity in those states. A business enterprise group definition of COMI may assist in global workouts but may prove problematic for the rights of creditors in various jurisdictions where they were dealing with companies registered in those jurisdictions and may want a remedy in respect of the particular business entity in that jurisdiction. Alternatively, there could be a recognition that the COMI may lie in multiple states, with protocols used to facilitate cases where it is more efficient to administer the proceeding on a consolidated basis in the home state of the parent corporation. Both strategies would recognize business enterprise groups. The objective is enhanced coordination, communication, expedition of the process, efficiency in the time and use of insolvency professionals, and fairness to local creditors.

In recognition of a business enterprise group proceeding, it is important that there not be an inappropriate extension of domestic law. At the same time, there is a need to recognize that operationally, the entities in the business enterprise group may be highly integrated and highly regulated in each of the jurisdictions in which the entities are registered. Absent agreement by parties to have one jurisdiction’s law apply to an integrated corporate organization, recognition of an “enterprise group COMI” could be an inappropriate extension of domestic law in one jurisdiction and could prejudice creditors located in those jurisdictions where priorities or preferences differ or where there are statutory protections such as “adequate protection” under the insolvency laws of the jurisdictions in which the subsidiaries are located. This issue highlights the differences in COMI in EU and non-EU jurisdictions, in that EU Member States have agreed in advance to the

75. *In re Betcorp Ltd.*, 2009 Bankr. LEXIS 569, 58 (Bankr. D.Nev. Feb. 9, 2009).

76. *Id.*

territorial reach of the insolvency law of the jurisdiction that recognizes COMI.⁷⁷ Adoption of a business enterprise group COMI would require its inclusion in the Model Law and adoption by various countries in order to make the provision meaningful, transparent, and certain for parties implicated in the business enterprise group's insolvency. However, it is equally important that the domestic law in the jurisdiction in which the subsidiaries are located does not inappropriately extend the reach of its law to the parent business entity located outside of the jurisdiction.

The center of main interest test does not really account for business enterprise groups, unless they are so highly integrated that a court can pull aside the corporate veil. Yet jurisprudence under corporate law in Canada, and many other jurisdictions, indicates that the occasions in which the corporate veil is lifted are rare.⁷⁸ Where there is a multinational enterprise with a controlling parent corporation, one issue is whether the parent corporation would ever attract liability for the debts of its insolvent subsidiaries located in other jurisdictions. Another issue is whether a parent's extensive control over the subsidiary will be sufficient to rebut the presumption that the location of the subsidiary's registered office constitutes its COMI.

The UNCITRAL Working Group has observed that any adoption of proceedings that recognize business enterprise groups would need to define the requisite level of integration. This requirement may place some onus on creditors to investigate or ascertain whether or not the corporation that they were dealing with was part of a business enterprise group.⁷⁹ While this onus may not pose a challenge for senior lenders who can require such disclosures as part of the due diligence in making credit decisions, such an approach would be very difficult for trade suppliers, employees, and other creditors that face bargaining and information asymmetries.

Even without resolution of the issue of whether there could be a "business enterprise group COMI," there are a number of strategies that can facilitate cross-border proceedings of business enterprise groups, as discussed in the next part.

V. CROSS-BORDER COOPERATION AND COORDINATION

The mechanism most frequently used to establish cross-border cooperation of business enterprise groups are protocols, or what UNCITRAL has termed "cross-border agreements," which set out the importance of comity and cooperation but recognize that each court is entitled to exercise its independent jurisdiction and authority at all times with respect to matters presented to it.⁸⁰ Protocols are aimed at harmonizing and coordinating activities, promoting the orderly and efficient administration of the proceedings, promoting international cooperation while respecting the independence and integrity of the courts, and implementing a framework of general principles to address fundamental and substantive issues arising out of the cross-border nature of the proceedings.⁸¹ The protocol may specify

77. Sarra, *supra* note 9, at 109.

78. Even in such a case, there are likely to be conflicts of law issues.

79. UNCITRAL Working Group V, *supra* note 3, para. 29.

80. *See, e.g.,* Hilton v. Guyot, 159 U.S. 113 (1895) (providing an example of U.S. recognition of French proceedings).

81. Janis Sarra, *Northern Lights, Canada's Version of the UNCITRAL Model Law on Cross-Border Insolvency*, 16 INT'L INSOLVENCY REV. 19, 31 (2007).

that it is aimed at facilitating reorganization of the business as a global enterprise, protecting the integrity of the process of administration, setting out the matters that are appropriately dealt with by insolvency professionals or courts in a particular jurisdiction, and ensuring timely and efficient mechanisms for resolution of claims disputes.⁸²

Protocols are usually negotiated by key parties to the proceedings and then endorsed by the relevant courts with oversight of the proceedings.⁸³ Typically, protocols are utilized to promote certainty and efficiency with respect to management and administration of the proceedings, to help clarify the expectations of parties, to reduce disputes and promote their effective resolution, and to assist in preventing jurisdictional conflict. UNCITRAL reports that in the *Everfresh* proceeding, it was estimated that enhancement of value through the cross-border agreement was in the order of forty percent.⁸⁴ “Protocols have been used effectively to reduce the cost of litigation and place the focus on restructuring issues instead of conflict of laws disputes.”⁸⁵

In some cases, the protocols have allowed for communication directly between judges; in other instances, only on procedural matters; and in still others, on substantive matters, with parties present or listening to the exchange.⁸⁶ In other cases, protocols have provided for joint hearings conducted by the courts in different jurisdictions.⁸⁷ “Such hearings allow parties on both sides of the border the benefit of making submissions and hearing concerns of the court without the ‘filter’ of reading their views in foreign judgments. Courts can signal parties regarding restructuring issues that concern the court’s particular jurisdiction and the hearings allow judges to communicate directly rather than through written judgments.”⁸⁸ Given the time-sensitive nature of restructuring proceedings, they can expedite decisions, cut costs in terms of numbers of court appearances, and facilitate decisions that have pragmatic and practical effect in both jurisdictions.

Protocols have been used most frequently in common law jurisdictions. While there was some question of the authority of civil law judges to endorse protocols, it has been suggested that a civil law judge could enter into a cross-border agreement

82. Sarra, *supra* note 9, 85 (2008) (“[F]or example, the protocol endorsed by the Canadian and U.S. courts in *PSINet Inc.* in 2001 specified that while there were full and separate contemporaneous main proceedings in Canada and the U.S., guidelines were necessary to coordinate certain activities, protect the rights of parties and ensure the maintenance of the courts’ respective independent jurisdiction and comity.”).

83. *Id.* at 84.

84. UNCITRAL *Draft Notes*, *supra* note 5, para. III.8(j). UNCITRAL, in its definition of cross-border agreements, specifies that they are “an agreement entered into, either orally or in writing, intended to facilitate the coordination of cross-border insolvency proceedings and cooperation between the courts, between the courts and insolvency representatives and between insolvency representatives, sometimes also involving other parties in interest.” *Id.* para. I.12(h).

85. Sarra, *supra* note 9, at 85.

86. JANIS SARRA, CROSSING THE FINISH LINE: THE POTENTIAL IMPACT ON BUSINESS RESCUE OF ADOPTION OF NEW CROSS-BORDER INSOLVENCY PROVISIONS 21–22, available at [http://www.ic.gc.ca/eic/site/bsf-osb.nsf/vwaj/Crossing_the_Finish_Line-EN.pdf/\\$FILE/Crossing_the_Finish_Line-EN.pdf](http://www.ic.gc.ca/eic/site/bsf-osb.nsf/vwaj/Crossing_the_Finish_Line-EN.pdf/$FILE/Crossing_the_Finish_Line-EN.pdf).

87. *E.g.*, joint U.S.-Canada hearings under the *Loewen* protocol, *The Loewen Group*, Initial Order under the CCAA, June 1, 1999, (Ont. S.C.J. Commercial List), Court File No. 99-CL3304.

88. JANIS SARRA, CREDITOR RIGHTS AND THE PUBLIC INTEREST, RESTRUCTURING INSOLVENT CORPORATIONS 286 (2003).

with a foreign court on the basis of its statutory obligation to prevent actions detrimental to the estate.⁸⁹ UNCITRAL has documented cross-border agreements between civil and common law jurisdictions; “in the *Nakash* case, for example, the Israeli court found statutory authorization for such agreement. In the *AIOC* case, an agreement was reached between the United States and the Swiss insolvency representatives, with the explicit endorsement of the responsible Swiss insolvency authority.”⁹⁰

While protocols are the mechanism, the substance contained in them, or more generally in recognition orders, can vary considerably from proceeding to proceeding. Elsewhere, I have suggested that there is a continuum of international cooperation, from communication to procedural coordination to substantive consolidation, including a mix of strategies where the proceedings involve a large number of related business entities with complex financing and governance arrangements.⁹¹ Here, two potential forms of cooperation, procedural coordination and substantive consolidation, are discussed in terms of the potential for insolvent multinational business enterprise groups.

A. *Procedural Coordination*

Procedural coordination allows for the coordination of proceedings in multiple jurisdictions with respect to multiple, related business entities. Procedural coordination can facilitate coordinated administration of insolvency proceedings with respect to two or more enterprise group members in the interests of creditors and debtors, while respecting the separate legal identity of each group member, including ensuring that the respective assets and liabilities of each entity are respected.⁹²

Procedural coordination has the ability to encourage both cost efficient and timely proceedings by facilitating the spreading of information pertaining to the financial activities of the enterprise group members, facilitating valuation of assets, coordinating sale of assets, and assisting in identifying inter-group liabilities.⁹³ Such coordination can enhance cooperation between the courts, coordination of hearings, and cooperation between insolvency representatives, including information sharing and coordination of negotiations. The insolvency law should establish requirements for giving notice with respect to applications and orders for procedural coordination and modification or termination of procedural coordination; including the scope and extent of the order, to whom notice should be given, the party responsible for giving notice, and the content of the notice.⁹⁴ In those jurisdictions that require creditors’ committees, it can include a single creditors’ committee or coordination between creditors’ committees.⁹⁵

89. *UNCITRAL Draft Notes*, *supra* note 5, para. III.18.

90. *Id.*, para. III.19 (“The agreements in the *ISA-Daisytek* and *SENDO* proceedings are further examples of agreements between civil and common law jurisdictions, involving the United Kingdom and Germany and France. There have also been agreements involving only civil law jurisdictions, for example in the *EMTEC* proceedings, involving France and Germany.”).

91. *See* Sarra, *supra* note 9, at 84.

92. *Id.* at 89.

93. *Id.* at 89–90.

94. UNCITRAL Model Law, *supra* note 3, Ch. para. III.157–60.

95. *Id.*, para. III.160.

Procedural coordination may involve coordination of procedures for filing of claims in accordance with the insolvency law of each jurisdiction and assisting in identification and processing of creditors' claims. It can allow a single claims process before one court, notwithstanding that there are multiple entities and numerous proceedings. "A common claims procedure avoids duplication of proceedings and reduces transaction costs."⁹⁶ "Creditors' claims remain as claims to the value of the assets of the particular entity with which the creditor contracted. Creditors deal with the interrelatedness of the corporate entities and any inappropriate shifting of assets in the pre-insolvency period by bringing claims for preference or other reviewable transactions."⁹⁷ However, the procedure to disclose the nature of assets and liabilities, and to determine the claims, is streamlined before one court that will admit claims and resolve any disputes. Equally, however, procedural coordination may involve allocating different kinds of claims to the courts of different jurisdictions involved⁹⁸ or may involve the courts jointly making such determinations. In all these situations, coordination can allow common creditor lists, a consolidated service list for provision of notice, mechanisms to resolve differences in the priority of claims where entities are operating in many jurisdictions, and may include joint hearings or joint meetings of creditors. Procedural coordination can include the appointment of a single receiver, trustee, administrator, or other insolvency professional to assist with the proceedings or provide for coordination of such professionals.

However, consolidation of claims and other procedures in one jurisdiction for a cross-border enterprise group can raise serious potential barriers for smaller trade suppliers or employee groups, who face collective action problems in terms of being able to participate in hearings in a foreign jurisdiction or even to make the appearance in that other jurisdiction to voice concern about the potential prejudice to their interests. While some jurisdictions may provide for representative counsel for particularly vulnerable groups or provide unsecured creditors' committees to address such barriers, where such mechanisms are not available, an issue arises as to how the court can be assured of the fairness and reasonableness of orders being sought with respect to the business enterprise group when all stakeholders are not before it.⁹⁹

Procedural coordination can reduce costs and expedite the proceedings. Where the entities are located in multiple jurisdictions, the courts have balanced interests and prejudice in making a determination as to whether to endorse procedural consolidation.

96. Sarra, *supra* note 9, at 90.

97. *Id.*

98. *E.g.*, *Victrix S.S. Co. v. Salen Dry Cargo A.B.*, 825 F.2d 709 (2d Cir. 1987) (approving dismissal of a claim against a debtor in a Swedish insolvency proceeding in deference to that proceeding); *Cunard S.S. Co. v. Salen Reefer Services AB*, 773 F.2d 452 (2d Cir. 1985) (approving dismissal of order of attachment in favor of an insolvency proceeding in Sweden); UNCITRAL, *supra* note 5, at para. II.21.

99. *See* *GMAC Commercial Credit Corp. – Canada v. TCT Logistics Inc.*, [2006] 2 S.C.R. 123, paras. 89–92 (Can.) (demonstrating where Canadian courts have addressed this issue in part by their careful admonition to monitors and proposal trustees that they are to be impartial officers of the court and are to have regard to the interests of all stakeholders).

B. *Substantive Consolidation*

Substantive consolidation treats member entities of a business enterprise group as one entity, pooling the assets and liabilities of two or more members of an enterprise group to create a single insolvency estate for the benefit of creditors of the substantively consolidated members.¹⁰⁰ Substantive consolidation usually results in the extinguishing of intra-group liabilities and treats the assets as belonging to a single consolidated estate.¹⁰¹ In the context of liquidation, substantive consolidation creates a common pool of assets to meet creditors' claims.¹⁰² In the context of restructuring, it may create the opportunity for creditors to share in the future upside potential of a restructured entity, or entities, by centralizing and negotiating an arrangement in respect of their claims. Substantive consolidation is undertaken more rarely than procedural coordination, because it disregards the separate legal personality of the entities in a business enterprise group, contrary to our notions of the separate legal personality. However, where assets and liabilities are so intertwined that it is difficult to separate out the separate legal personalities, substantive consolidation has been an effective mechanism to address the business group's insolvency.¹⁰³

Where management or financing control is centralized, the enterprise group may need to file concurrently in multiple jurisdictions in order to continue operating, because a stay in one jurisdiction is not sufficient to allow such a centralized structure to continue during the workout negotiation process. The debt structure may be highly integrated, with inter-company loans that cross borders. There may be guarantees by one entity for another or by the officers of the company for debts of a member of the business enterprise group. Hence, the business enterprise group may need to be treated as an integrated whole, rather than numerous separate entities. In addition to pooling assets and liabilities, substantive consolidation usually extinguishes guarantee claims against any consolidated entity that guaranteed the obligations of another consolidated entity.¹⁰⁴

Often a single insolvency professional is appointed, although, as UNCITRAL notes, that may depend on the stage in the proceeding at which consolidation occurs.¹⁰⁵ Although there is not yet consensus among the UNCITRAL Working Group countries with respect to when an application may be appropriate for substantive consolidation, the current deliberations suggest that substantive consolidation with respect to two or more enterprise group members would take place only where the court is satisfied that the assets or liabilities of the enterprise

100. See The Secretariat, U.N. Comm'n on Int'l Trade Law, Working Group V (Insolvency Law), *Legislative Guide on Insolvency Law, Part Three: Treatment of Enterprise Groups in Insolvency*, para. 14, U.N. Doc. A/CN.9/WG.V/WP.82/Add.3 (Sept. 5, 2008).

101. *Id.* para. 37.

102. The Secretariat, U.N. Comm'n on Int'l Trade Law [UNCITRAL], Working Group V (Insolvency Law), *Treatment of Corporate Groups in Insolvency*, para. 35, U.N. Doc. A/CN.9/WG.V/WP.74/Add.1 (Oct. 4, 2006) [hereinafter *Treatment of Corporate Groups in Insolvency Add.1*] (describing the methods and effects of pooling resources in substantive consolidation proceedings).

103. *Id.* para. 36 (noting the appropriateness of substantive consolidation when "it would be difficult, if not impossible, to disentangle the assets and liabilities of the different entities").

104. *Id.* para. 43 ("Individual creditors [subject to substantive consolidation] may also be affected by the court treating as invalid any charges, guarantees or other intra-group securities between the companies in liquidation.").

105. *Id.* paras. 12, 14 (discussing the appointment of an "insolvency representative").

group members are intermingled to such an extent that the ownership of assets and responsibility for liabilities cannot be identified without disproportionate expense or delay; or where the enterprise group members are engaged in fraudulent schemes or activity with no legitimate business purpose and the court is satisfied that substantive consolidation is essential to rectify that scheme or activity.¹⁰⁶

Generally, the specific rights and remedies of secured creditors are preserved on substantive consolidation, unless the security is between members of the business group and the consolidation order has extinguished those debts.¹⁰⁷ In many jurisdictions, security is over specific property or assets, and where reorganization is the objective of the insolvency proceeding, secured creditors' claims may or may not be stayed for a limited period of time while the business group tries to work out its affairs.¹⁰⁸ In countries that allow general security agreements, or floating charges over substantially all of the assets of the business, substantive consolidation may require the court to temporarily stay the rights of secured creditors to realize their claims in order to give the enterprise group the "breathing space" to try to devise a going-forward business plan and to negotiate with credits. In either case, absent a stay order, there can be a race to the assets by secured lenders such that the business has no ability to reorganize to stay in business and preserve jobs and economic activity.

Orders for consolidation, particularly for business groups than span multiple jurisdictions, need to specify the insolvency law that applies; including what priority of claims will apply, what law will govern any avoidance transactions brought against the consolidating entity with respect to preferences or transfers at undervalue, and what law will govern any granting of post-commencement financing, as discussed below.¹⁰⁹ These rights and remedies vary considerably across jurisdictions and are significantly affected by a substantive consolidation order. The difficulty is that local creditors, that may enjoy a priority with respect to their claim or have a particular remedy in their own jurisdiction for a voidable transaction, may lose that priority or benefit where the insolvency law applied to the consolidated entity differs from the advantages they enjoy domestically. This prejudice can be significant, and arguably there must be compelling grounds to allow such prejudice or it needs to be compensated within the consolidated proceeding.

There can also be a partial substantive consolidation; specifically, the court may exclude specified entities or exclude specified assets or claims from an order for substantive consolidation, such as excluding secured creditors to the extent they relied on the encumbered assets. The UNCITRAL Working Group observes that a court may determine, with respect to a solvent member of the enterprise group, that

106. The Secretariat, U.N. Comm'n on Int'l Trade Law [UNCITRAL], Working Group V, *Treatment of Enterprise Groups in Insolvency*, para. 17, U.N. Doc. A/CN.9/WG.V/WP.80/Add.1 (Jan. 2, 2008).

107. *Treatment of Corporate Groups in Insolvency Add.1*, *supra* note 102, paras. 43–44 (discussing the general recognition of the rights of secured creditors and the status of "intra-group securities between the companies in liquidation").

108. Addendum, United Nations Commission on International Trade Law, Post-commencement financing in international reorganizations, para. 49, U.N. Doc. A/CN.9/582/Add.5 (Apr. 15, 2005) (discussing "staying any action by creditors against the debtor's assets" as an optional measure to aid reorganization).

109. *Treatment of Corporate Groups in Insolvency Add.2*, *supra* note 1, para. 31.

consolidation includes only the net equity of the solvent members, leaving their creditors unaffected.¹¹⁰

Canadian courts have recognized substantive consolidation under both its principle insolvency and bankruptcy statutes, the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act.¹¹¹ The courts will order substantive consolidation where there is evidence of intertwined assets and liabilities, integrated administrative functioning and operations of the entities in the business enterprise group, a perception by creditors that they are dealing with an integrated entity, common control and governance structures, where it would be impracticable to separate the affairs of related entities, where it is more cost-effective and beneficial to creditors to have the proceedings administered as a single estate, and where it would result in an expeditious and administratively efficient administration of the proceeding.¹¹² In *PSINet*, the Ontario Superior Court held that a consolidated plan reflected the intertwined nature of the assets and operations of the entities and avoided the complex and litigious issues surrounding the allocation of the proceeds from the sale of substantially all of the assets of the corporate group.¹¹³ In other cases, Canadian courts have declined to approve requests for substantive consolidation on the basis that while the finances and control were highly inter-related, consolidation would prejudice the substantive rights of creditors.¹¹⁴

The principles applied by the Canadian courts are: the requirement of evidence of significant intertwining of financial affairs, business operations, and control; the need for fairness and reasonableness of the proposed strategy; the extent to which a consolidated plan avoided complex and litigious issues surrounding the allocation of proceeds; the comingling of records and inventory; and the amount, degree, and type of prejudice to creditors that may result from a substantive consolidation, the issue of prejudice being an overriding principle.¹¹⁵ Creditor consent is also a factor to

110. *Id.* at 5, 7.

111. Bankruptcy and Insolvency Act, 1985 R.S., c.B-3 (Can.); Companies' Creditors Arrangements Act, 1985, R.S., c.C-36 (Can.).

112. *See Re Associated Freezers of Canada Inc.*, [1995] 36 C.B.R. (3d) 227, para. 1 (Ont. Ct. J. (Gen. Div.)) (looking to the effect consolidation would have on the secured and unsecured creditors); *Re J.P. Capital Corp.*, [1995] 31 C.B.R. (3d) 102, para. 19 (Ont. Ct. J. (Gen. Div.)) (recognizing the court's authority to grant consolidation, but exercising its discretion not to grant it given the circumstances); *Re A. & F. Baillargeon Express Inc.*, [1993], 27 C.B.R. (3d) 36, paras. 22–24 (Que. S.C.) (holding that provisions in the Bankruptcy and Insolvency Act allow the court to consider consolidation and observing that even though there is no provision in the Companies' Creditors Arrangement Act explicitly authorizing consolidation, consolidation has been allowed when companies' affairs are intermingled); *Re Northland Properties Ltd.*, [1988] 69 C.B.R. (N.S.) 266, para. 37 (B.C.S.C.) (adopting the following elements: (1) difficulty in segregating assets, (2) presence of consolidated financial statements, (3) profitability of consolidation at a single location, (4) commingling of assets and business functions, (5) unity of interests in ownership, (6) existence of intercorporate loan guarantees, and (7) transfer of assets without observance of corporate formalities), affirmed, [1989] 73 C.B.R. (N.S.) 195 (B.C. C.A.).

113. *Re PSINet Ltd.*, [2002] 33 C.B.R. (4th) 284, para. 2 (Ont. S.C.J.).

114. *Ashley v. Marlow Group Private Portfolio Management Inc.*, [2006] 22 C.B.R. (5th) 126 para. 78 (Ont. Sup. Ct.); *Ontario (Securities Commission) v. Portus Alternative Asset Management Inc.*, [2006] 19 C.B.R. (5th) 17, para. 120 (Ont. S.C.J.).

115. *See Re PSINet Ltd.*, 33 C.B.R.4th 284, para. 7 (examining the strict compliance with the statute, the examination of materials filed and procedure, and the fairness and reasonableness of the plan); *Re Associated Freezers of Canada Inc.*, [1995] 36 C.B.R.3d 227, para. 5 (considering the need for a clear identification of the corporate structure and assets, and the effect of a distribution on creditors); *see also*, *Global Light Telecommunication Inc.*, [2004], 2 C.B.R. (5th) 210, para. 23 (B.C. S.C.) (discussing the distribution of proceeds).

consider, given that the effect of such an order is to create a common pool of assets, and that the amount of creditor support for the plan is gauged after creditors have been being allowed sufficient time and information to make a reasoned decision.¹¹⁶

In the United States, courts have approved substantive consolidation orders, although more recently the courts have adopted more stringent criteria.¹¹⁷ The courts have balanced whether substantive consolidation yields benefits that outweigh the harm or prejudice created by the consolidation.¹¹⁸ In *re Owens Corning*, the U.S. Court of Appeals, Third Circuit, held that there are a number of principles to consider in applications for consolidation; such principles serve as a guide, not a checklist.¹¹⁹ Those principles include: “limiting the cross-creep of liability by respecting entity separateness,” and understanding that “the harms substantive consolidation addresses are nearly always those caused by debtors and entities they control who have disregarded separateness.”¹²⁰ The Court held that substantive consolidation as an equitable remedy may be available where the entities disregarded the separateness of the corporate entity so significantly that their creditors relied on the breakdown of entity borders and treated them as one legal entity; or that post-petition, their assets and liabilities were so scrambled that separating them was prohibitive and hurt all creditors.¹²¹ The Court held that “commingling justifies consolidation only when separately accounting for the assets and liabilities of the distinct entities will reduce the recovery of every creditor—that is, when every creditor will benefit from the consolidation.”¹²²

Australia previously had conflicting judicial judgments with respect to whether substantive consolidation, called pooling, was permitted under the statutory language, even where assets and liabilities were substantially intertwined.¹²³ As a result, Australia enacted a statutory substantive consolidation regime, which provides for both voluntary pooling of assets and court-ordered pooling, with

116. *Re Northland Properties Ltd.*, 69 C.B.R. (N.S.), para. 59.

117. *In re Owens Corning*, 419 F.3d 195 (3rd Cir. 2005), citing *In re Commercial Envelope Mfg. Co.*, 3 Bankr. Ct. Dec. 647, 648, 1977 WL 182366 (Bankr. S.D.N.Y. 1977). The courts have relied on §§ 105(c) and 1123(a)(5)(C) of the U.S. Bankruptcy Code to find authority. See *Soviero v. National Bank of Long Island*, 328 F.2d 446 (2d Cir. 1964); *Chemical Bank New York Trust Co. v. Kheel (In re Seatrade Corp.)*, 369 F.2d 845 (2d Cir. 1966); *Flora Mir Candy Corp. v. R.S. Dickson & Co. (In re Flora Mir Candy Corp.)*, 432 F.2d 1060 (2d Cir. 1970); and *Talcott v. Wharton (In re Continental Vending Machine Corp.)*, 517 F.2d 997 (2d Cir. 1975); *In re Augie/Restivo*, 860 F.2d 518; *In re Auto-Train Corp., Inc.*, 810 F.2d 270, 276 (2d Cir. 1987). See Mary Kors, *Altered Egos: Deciphering Substantive Consolidation* 59 U. PITT. L. REV. 381 (1998); and Douglas Baird, *Substantive Consolidation Today* 47 B.C. L. REV. 5, 15 (2005).

118. *In re Auto-Train Corp., Inc.*, 810 F.2d 270, 276 (2d Cir. 1987). See also, *In re Augie/Restivo Banking Co. Ltd.*, 860 F.2d 515 (2d Cir. 1988) (holding that substantive consolidation benefits did not outweigh the harms).

119. *In re Owens Corning*, 419 F.3d 195 (3rd Cir. 2005), reversing 316 B.R. 168 (D. Del. 2004). The court of first instance had approved substantive consolidation, but it was subsequently overturned on appeal.

120. *Id.* at 211.

121. *Id.* at 210–211. The Court further held that there must be more gained from substantive consolidation than the merely administrative convenience; substantive consolidation should be rare and a remedy of last resort after considering and rejecting other available remedies.

122. *Id.* at 214.

123. *Re The Black Stump Enterprises Pty Ltd.* (2005) 228 A.L.R. 591 (holding that the appellate court had no authority to order the pooling of assets in a liquidation of a business enterprise group, despite the fact that commercial sense and expediency indicated that pooling would be appropriate).

specified criteria under the statute.¹²⁴ That criteria specifies that each company in the business enterprise group must be in the process of being wound up; each company must be related; the companies are jointly liable for one or more debts or claims; or the companies jointly own or one of them owns or operates property that is or was used in connection with a business, scheme, or undertaking carried on by them jointly.¹²⁵ There are procedural requirements of notice and creditor approval.¹²⁶ The notice must specify the liquidator's reasons for proposing pooling; including whether it will be in the creditors' interests, the extent of disadvantage to creditors, the likely return to creditors in and outside pooling, and any other information known to the liquidator that will enable creditors to make an informed decision.¹²⁷ Under voluntary pooling, the majority of creditors of each company holding seventy-five percent or more of the total amount of debts and claims must approve the pooling.¹²⁸

Under the court-ordered pooling provisions in Australia, the liquidator can bring an application, on notice, for a court order, and the court has the authority to order pooling only if it is satisfied that it is just and equitable to do so based on the same factors as under voluntary pooling.¹²⁹ The court must also assess the following criteria: the conduct of the companies towards creditors or other companies in the group, the extent to which circumstances that gave rise to the liquidation of any of the companies are directly or indirectly attributable to the acts or omissions of other companies or their corporate officers, the extent of intermingling of the management and business activities of the companies, the extent to which creditors will be impacted by a pooling order, and any other relevant matters.¹³⁰ Pooling results in each company in the group becoming jointly and severally liable for all unsecured debts owed by each group member and all inter-company debts and claims are extinguished.¹³¹ Interestingly, the Australian pooling provisions are aimed at liquidations,¹³² yet one argument for allowing substantive consolidation for a business enterprise group is that reorganization would allow the business to become viable again and creditors are able to bargain for some upside potential that may compensate for any short term prejudice to their claims.

124. Corporations Amendment (Insolvency) Act, 2007, sched. 1, pt. 4, available at <http://www.comlaw.gov.au/ComLaw/Legislation/Act1.nsf/asmade/bytitle/40461A7B3A564578CA2573400079EDF2?OpenDocument>. See Jenny Dickfos et al., *The Insolvency Implications for Corporate Groups in Australia—Recent Events and Initiatives*, 16 INT'L. INSOLVENCY REV. 103 (2007) (discussing the implications of Schedule 1, Part 4 of the Corporations Amendment (Insolvency) Act for Australian companies). The provisions do not “apply in relation to a secured creditor unless the relevant debt is payable by a company or companies in the group to any other company or companies in the group.” Corporations Amendment (Insolvency) Act, *supra*, § 571(9).

125. Corporations Amendment (Insolvency) Act, *supra* note 124, § 571.

126. *Id.* §§ 572–75, 577–78.

127. *Id.* §§ 574(3)(b). The liquidator is to act with due care, in good faith, and “for the benefit of all creditors of the companies in the group, considered as a whole.” Corporations Amendment (Insolvency) Act, § 579(1).

128. *Id.* § 577(2).

129. *Id.* §§ 579E(1), 579E(11).

130. *Id.* § 579E(12). The court has jurisdiction to exempt certain debts or claims from the operation of pooling; transfer liability for certain debts or claims from one company in the group to another; or make any order as the court thinks fit. *Id.* § 579G(1).

131. Corporations Amendment (Insolvency) Act, *supra* note 124, § 579E(2).

132. DAVID COWLING, POOLING IN AUSTRALIAN CORPORATE INSOLVENCY, <http://www.ebalawyers.com.au/system/files/download/o119/SIN95.pdf> (last visited Apr. 10, 2009).

Both the case law and the statutory provisions in the jurisdictions discussed above point to the need for compelling circumstances before the separate legal personalities are to be disregarded in favor of substantive consolidation of a business enterprise group in an insolvency proceeding.

In considering a framework for dealing with cross-border insolvencies of enterprise groups, an overarching principle is respecting entity separateness; a fundamental tenant of corporate law, partnership law, and trust law in many jurisdictions. Respecting the separate legal personality allows transparency and certainty with respect to legal duties and obligations, limits on liability for the entity's conduct, and clarity in entitlement to the profits or residual assets on wind-up. Another principle is that the court should, as an objective, minimize the degree of prejudice to creditors that a substantive consolidation order would create. In this respect, the court should carefully consider the amount, degree, and type of prejudice to creditors, and whether that prejudice is outweighed by the potential benefits to be realized on consolidation. The court should consider whether those creditors that may be prejudiced have had the opportunity to make submissions to the court. The court should take into account the extent to which the request is aimed at harmonizing and coordinating activities, and promoting the orderly and efficient administration of the proceedings. The court should balance the promotion of international cooperation with respect for the independence and integrity of domestic proceedings.

The court should not consolidate on a procedural or substantive basis where to do so would raise serious barriers for smaller creditors and employee groups to participate in hearings in a foreign jurisdiction. Consideration of mechanisms, such as representative counsel, that try to redress that imbalance may be a factor. Finally, the court should be satisfied that parties have the right to notice of the proceedings and any developments, the right to appear and be heard, protection against unilateral modification of prior agreements under a protocol absent endorsement of both courts, procedures to resolve disputes arising out of a protocol, and preservation of domestic rights to the greatest extent possible.

In this respect, in assessing requests for substantive consolidation, the court should consider whether there are less intrusive proceedings to address enterprise group insolvency. The court should consider whether the intertwined assets and liabilities and integrated administrative functioning and operations of the entities in the business enterprise group are such that it is difficult or impossible to separate out creditors' claims. Another consideration is whether there are common control and governance structures that make it impracticable to separate the affairs of related entities in a manner that is cost-effective and beneficial to creditors. Other considerations include the quality of the "evidence of significant intertwining of financial affairs, business operations and control; the need for fairness and reasonableness of the proposed strategy; the extent to which a consolidated plan avoided complex and litigious issues surrounding the allocation of proceeds from the sale of substantially all of the debtor companies' assets; the comingling of records and inventory; and the amount, degree, and type of prejudice that may result from a substantive consolidation."¹³³ The courts may consider the capital structure of the

133. Sarra, *supra* note 9, at 95.

subsidiary where it is integrally tied to the parent, whether it is under-capitalized, and whether the entities exhibit evidence of operating as separate legal personalities.

Where there is a substantive consolidation of proceedings, it also raises the question of whether there should be creditors' committees, which would have representation from creditors of the parent enterprise, as well as subsidiaries in the business enterprise group. Currently, only some countries require such committees in insolvency proceedings.¹³⁴ Even such a structure may create barriers to the participation of unsecured creditors where creditors are located in jurisdictions other than where the proceeding is being conducted. It may also raise a question with respect to the ability of employees and pensioners to participate in workout proceedings where the business enterprise group proceeding is not in their domestic jurisdiction. This barrier to participation may include both informational and cost barriers, resulting in the court not having all the interests at stake before it in the courtroom when making substantive decisions with respect to the proceeding. Consolidation implicates notions of creditors' reasonable expectations as well as public interest and public policy with respect to the fairness and efficacy of the insolvency regime.¹³⁵

Recognition of a global integrated unit for purposes of an insolvency proceeding may also have implications for local directors, who have fiduciary obligations and duties of care under their domestic corporations or business legislation. They may also face personal liability to certain classes of creditors for the debts of the subsidiaries under the insolvency laws in the jurisdiction of the subsidiaries if there are not sufficient assets in the corporation to satisfy these claims. If they are nominee directors that have been engaged in oversight in a subsidiary, it may be difficult to transition to governance of a global unit, even though the financial control had been at the business enterprise group level. Equally, where local nominee directors have not been involved in governance of the corporation as it is part of an integrated business enterprise group, they will be at a loss to deal with the financial distress of the entity. The insolvency system needs to take account of how decisions are being made functionally in the business enterprise group. At the same time, the directors of each entity within a business enterprise group have a fiduciary obligation to act in the best interests of that entity, which may or may not align with the best interests of the business enterprise group as a whole.

VI. FINANCING THE INSOLVENT BUSINESS GROUP DURING PROCEEDINGS

Finally, an important issue for cross-border proceedings, whether they entail procedural coordination or substantive consolidation of the enterprise group, is the availability of post-commencement financing, colloquially referred to as debtor in possession (DIP) financing in a number of jurisdictions. Post-commencement financing refers to the working capital that the debtor business requires in order to

134. See Eva Maria Huntemann, *German Insolvency Code Shows Chapter 11 Influence*, Jan. 1, 2004, <http://www.turnaround.org/Publications/Articles.aspx?objectID=2846> (last visited Apr. 4, 2009) (discussing the Insolvency code of Germany); see Javier Canosa, *Insolvency Proceedings in Argentina*, <http://www.hg.org/article.asp?id=5051> (last visited Apr. 4, 2009) (discussing the insolvency procedures of Argentina).

135. See Sarra, *supra* note 9, at 95.

keep operating after the commencement of insolvency proceedings, with a view to preserving going concern value while trying to negotiate a restructuring plan that is acceptable to creditors or with a view to a going concern sale of the business. The premise underlying such financing is that it is a benefit to all stakeholders, as it can allow business entities to continue operations and preserve employment, goodwill, and economic activity, while the fate of the business group is being determined. The financing can cover interim operating costs, such as payroll costs, or the payment of critically important goods and services that are required to maintain business activities during the workout period. Such financing can also cover the administrative expenses of the insolvency proceedings, including the costs of insolvency accounting and legal professionals.

Where the debtor has no liquid assets to meet its immediate cash flow needs, lenders will advance new financing after commencement of insolvency proceedings, only if their loan is given secured priority over pre-existing secured and unsecured loans. However, the authority of courts to offer a priority over pre-filing creditors varies considerably from jurisdiction to jurisdiction. Different jurisdictions have different priorities for creditors on liquidation, some of which cannot be affected by post-commencement financing. Some countries, such as the United States, have highly codified provisions, such as absolute priority rules, which may influence the ability to obtain post-commencement financing. In other jurisdictions, such as Canada, there is no express statutory language and courts have exercised their general authority to grant post-commencement financing.¹³⁶ Canadian courts have applied the following principles in their consideration of applications for post-commencement financing and priority charges: adequate notice and disclosure of financing and priming requests, so that creditors can fully assess the impact; timeliness of the request; prejudice to creditors and other stakeholders; and the principle of granting priority financing as an extraordinary remedy.¹³⁷

Post-commencement financing is particularly challenging for cross-border business enterprise groups, as different jurisdictions may or may not permit financially healthier members of the group from advancing funds to the insolvent members. UNCITRAL observes that post-commencement financing can advance the objective of fair apportionment of benefit and detriment among all group members, allowing such financing to take place between members of the group.¹³⁸ In the cross-border context, “many insolvency laws either restrict the provision of new money in insolvency or do not specifically address the provision of new finance or the priority for its repayment in insolvency,” creating uncertainty for business enterprise

136. See *Re United Used Auto & Truck Parts Ltd.* (1999), 12 C.B.R. (4th) 144 (B.C. S.C. [In Chambers]), affirmed (2000), [2000] B.C.J. No. 409, 16 C.B.R. (4th) 141 (B.C. C.A.), leave to appeal allowed but appeal discontinued (2000), [2000] S.C.C.A. No. 142, 2000 CarswellBC 2132, 2000 CarswellBC 2133 (S.C.C.); *Re Dylex Ltd.* (Jan. 23, 1995), Doc. B-4/95 (Ont. Gen. Div.); *Re T. Eaton Co.*, (1997), 1997 CarswellOnt 5954 (Ont. Gen. Div.); *Re Consumers Packaging Inc.* (May 23, 2001); *Re Consumers Packaging Inc.* (May 30, 2001), Doc. 01-1865 (U.S. Bankr. D. Del., 2001) and Doc. 01-1865 (Bankr. D. Del., 2001) (June 12, 2001).

137. See *Re Boutiques San Francisco Incorporées*, (Dec. 17, 2003), Doc. C.S. Montréal 500-11-022070-037, [2003] Q.J. No. 18940 (Que. S.C.) para. 32 (citing Janis Sarra, *Debtor in Possession Financing: The Jurisdiction of Canadian Courts to Grant Super-priority Financing in CCAA Applications* 23 DALHOUSIE L. J. 337 (2000)).

138. UNCITRAL Working Group V, *supra* note 3, para. 21.

group proceedings.¹³⁹ UNCITRAL has observed that many cross-border protocols or agreements do not address the provision of post-commencement financing or the court order approving the agreement contains only general language, such as authorizing the parties to pursue all avenues of refinancing and the sale of material parts of their business or assets, subject to prior approval of the court and the lenders.¹⁴⁰ UNCITRAL notes that the *Maxwell* protocol included a provision that the insolvency representative with responsibility for operation of the business required the consent of the other insolvency representatives and approval of the court of the other forum to obtain financing, regardless of whether that consent was required under the applicable law, in order to ensure that the parallel insolvency proceedings achieved the goal of maximizing the value of the estate and preserving the interests of each of the insolvency regimes involved.¹⁴¹ Another agreement specified that any new financing lender “should only be subject to the jurisdiction in which the post-commencement financing was provided.”¹⁴² UNCITRAL has observed that domestic insolvency law should specify the priority that applies to post-commencement financing provided by one enterprise group member subject to insolvency proceedings to another group member, that is also subject to insolvency proceedings.¹⁴³ A security interest for post-commencement financing may be granted in circumstances where creditors consent, or where a determination is made in accordance with the governing insolvency law that any harm to creditors is offset by the benefit to be derived from the granting of the security interest.¹⁴⁴

A lender offering post-commencement financing during an insolvency proceeding expects a bundle of rights to accompany the financing in terms of credit arrangements and fees, protection against being primed by new post-filing lenders, and with respect to oversight controls during the period that the business group continues to operate while it is negotiating a plan of arrangement and compromise. Many post-commencement financing facilities are provided by existing lenders, usually to protect their pre-filing position so that no other lender has priority over their claim. In terms of priority charges, the post-commencement financing lender may insist on security over assets of entities in the business group that still have unencumbered assets, creating potential risk to creditors of that entity.¹⁴⁵

Post-commencement financing may provide another oversight mechanism for managerial activity during negotiations for a viable plan of arrangement. Where the lender is a pre-filing creditor, it may have a strong interest in the success of the business going-forward, both in terms of satisfying its existing claims and the expected value from a continuing lending relationship with one or more of the business entities in the enterprise group. In such a case, there is likely to be a convergence of interest with less-protected creditors that have a stake in the business as a going concern. Unsecured and under-secured creditors may also benefit from the provision of continued working capital and from any governance improvements negotiated by the post-commencement financing lender in the financing agreement.

139. *Id.* para. III.135.

140. *Id.* para. III.136.

141. *Id.*

142. *Id.*

143. UNCITRAL Working Group V, *supra* note 3, para. III.135–136.

144. UNCITRAL Working Group V, *supra* note 3, para. III.135.

145. *See Re Intertan Canada Ltd.* (2009), 2009 CarswellOnt 324 para. 27 (Ont. S.C.J. [Commercial List]).

These lenders also have considerable access to information in undertaking their due diligence prior to negotiating a financing agreement. The post-commencement financing lender may be the party best positioned at the commencement of insolvency proceedings to determine that there is a potential upside value to be generated by having various members of the business enterprise group restructured.

The limited pool of post-commencement lenders provides them with considerable bargaining power in negotiations for a post-commencement financing agreement, including control rights. Under the Teleglobe post-commencement financing agreement, the lender was expressly given the right to approve any form of order coming before the court.¹⁴⁶ A new lender may have little concern about the outcome of the insolvency proceedings, since its claims are fully protected and it has no pre-filing debt that may be underwater. Given the controls that it extracts in the post-commencement financing agreement, the post-commencement lender may unduly pressure the business enterprise to consider its interests above those of other creditors. Where the post-commencement lender is not a pre-filing creditor, it may have different timelines in terms of satisfying its claims. As a consequence, the post-commencement creditor may encourage the business enterprise group to consider liquidation prematurely, when there is still value in the business that could accrue to junior secured and unsecured creditors.

In many cases, oversight exercised by post-commencement lenders can enhance governance, in the sense of providing another check on the activities of corporate directors and officers.¹⁴⁷ However, there may also be situations that call for a governance change, but post-commencement lenders and other secured creditors are not prepared to intervene, as there is a risk that their ability to sell claims would be hampered because they would fall within the definition of insider trading under financial services legislation.

UNCITRAL observes that there may be issues as to whether the parent corporation could borrow operating and administration funds and direct those funds to a subsidiary in another jurisdiction, and the inability to have a priority recognized works directly to defeat restructuring efforts.¹⁴⁸ Its Working Group has also observed that some of the structural impediments to providing new money include: personal liability of insolvency representatives, directors, or officers for incurring the debts that such financing would entail; problems associated with providing priority to post-commencement finance; and a preference for liquidation over reorganization that makes the issue of such financing difficult to address.¹⁴⁹ It also suggests that the issue of which entities could access funds could be approved concurrently through protocols approved by courts with concurrent jurisdiction, and that such a strategy

146. In the matter of the Companies' Creditors Arrangement Act and Teleglobe Inc. (May 15, 2002), Doc. 02-CL-4528 (Ont. S.C.J. [Commercial List]).

147. Janis Sarra, *Governance and Control: The Role of Debtor-in-Possession Financing under the CCAA*, ANNUAL REVIEW OF INSOLVENCY LAW, 2004 119–172 (Janis Sarra, ed. 2005).

148. See generally, Office of the Superintendent of Bankruptcy Canada Crossing the Finish Line: the Potential Impact on Business Rescue of Adoption of new Cross-Border Insolvency Provisions – Part 2, http://www.ic.gc.ca/eic/site/bsf-osb.nsf/eng/br02022.html#_ftnref40 (last visited Apr. 8, 2009) (“The UNCITRAL Legislative Guide notes that many jurisdictions restrict the provision of new money in insolvency or do not address the issue of new financing . . .”).

149. *Id.*

would assist in resolving any issues with respect to the uncertainty of who is liable for non-payment of the priority financing.¹⁵⁰

Thus, while there are instances in which post-commencement financing has been made available to multinational business enterprise groups, experience to date suggests that there are a number of challenges that still need to be addressed, particularly in terms of recognition of the priority of the claim of the post-commencement financier, and the extent and scope in inter-entity loans and guarantees. Resolution of these issues is critically important, as absent the availability of post-commencement financing, many potentially viable businesses will not be afforded the opportunity to restructure their affairs and preserve economic activity.

VII. CONCLUSION

The treatment of cross-border business enterprise groups in insolvency is a timely and important issue. In the wake of the current financial crisis, such insolvencies are more common. Yet domestic insolvency law in most jurisdictions was not designed for, nor is particularly adept at, addressing cross-border business group insolvency. The Model Law, and similar instruments that are aimed at cross-border cooperation, can assist in addressing some of the procedural and recognition issues, but there may be barriers to dealing with the group as a whole where statutory criteria for recognition does not neatly align with the integrated nature of a global business enterprise. Tools such as protocols have, to a degree, filled a gap in domestic legislation, as it allows parties to negotiate cross-border co-operation, including recognition of procedural coordination or substantive consolidation with the courts in the implicated jurisdictions then approving the protocols. Such protocols may assist in overcoming some barriers to recognize the center of main interest, where domestic or regional law does not easily accommodate highly integrated business enterprise groups. The protocols set the contours of cooperation and can clarify the objectives of the particular insolvency proceeding in terms of liquidation, reorganization, or some combination as the anticipated outcome of the proceedings.

It is critically important to determine the scope of cross-border cooperation, be it merely recognition and communication, procedural coordination, or partial or full substantive consolidation. Each of these strategies for addressing the insolvency of a multinational enterprise group has its potential costs and benefits for creditors and other stakeholders implicated in the business group's financial distress. Some of the principles articulated above, including transparency, certainty, weighing of benefit and prejudice, and minimizing the degree of harm to legal rights, are all fundamental considerations in adopting a particular strategy in the insolvency proceeding.

150. *Id.*