INSOL INTERNATIONAL

THE RESTRUCTURING OF CORPORATE GROUPS

A GLOBAL ANALYSIS OF SUBSTANTIVE, PROCEDURAL AND SYNTHETIC GROUP PROCEDURES

INSOL INTERNATIONAL

International Association of Restructuring,
Insolvency & Bankruptcy Professionals

INSOL International, 6-7 Queen Street, London, EC4N 1SP
Tel: +44(0) 20 7248 3333 | Fax: +44(0) 20 7248 3384
www.insol.org

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PRESIDENT'S INTRODUCTION

Rapid technological and digital change and innovation have enabled business to be conducted across borders, very often making use of complex corporate group structures with various group entities, assets and creditors located in different jurisdictions across the world.

In this business and economic setting, there has never been a greater need for a consistent, predictable and uniform international framework for recognition, coordination and enforcement in relation to cross-border restructuring processes for group enterprises.

This has become a key focus point for the United Nations Commission on International Trade Law (UNCITRAL) through the activities of its Working Group V (Insolvency). In July 2019, UNCITRAL released the Model Law on Enterprise Group Insolvency (MLEGI), designed to address the specific needs of cross-border restructuring and insolvency processes impacting multiple group members, as distinct from the Model Law on Cross-Border Insolvency (MLCBI) which only deals with the insolvency context of a single debtor. The MLEGI draws upon some of the features identified in the European Insolvency Regulation Recast, and is also intended to operate in conjunction with Part 3 of the UNCITRAL Legislative Guide on Insolvency Law dealing exclusively with the treatment of enterprise groups in insolvency.

The adoption and implementation of the MLEGI – along with the further uptake of the MLCBI – will be priority areas for UNCITRAL, INSOL International, the World Bank and other international insolvency regulatory and policy bodies in the years ahead.

However, in the interim – and given that no jurisdiction has yet adopted and implemented the MLEGI – it is important to understand and analyse the various approaches taken by different countries to corporate group restructuring involving entities, assets and creditors across borders. It is also important to consider the potential for cooperation through novel means such as synthetic restructuring, taking after the cross-border undertakings offered by the joint English administrators in the landmark case of *Re Collins & Aikman Europe SA* [2006] EWHC 1343.

This new publication from INSOL International – *The Restructuring of Corporate Groups: A Global Analysis of Substantive, Procedural and Synthetic Group Procedures* – does precisely that. It consists of 18 country contributions, as well as a chapter looking specifically at how Brexit will shape corporate group restructuring recognition and cooperation in the United Kingdom and the European Union in future years. Each chapter identifies the potential for substantive, procedural and synthetic restructuring processes and draws attention to key cases, legislative provisions and international treaties. There is also a focus on future policy development that may shape the potential for coordinated proceedings and cooperation.

This book is an invaluable contribution to law reform and regulatory and policy development in relation to the implementation of a harmonised, consistent approach to cross-border restructuring processes in a manner that enhances efficiency, reduces costs and increases the prospect of viable enterprises being able to undergo successful corporate and business restructuring in the interests of debtors and creditors alike. Importantly, those outcomes also provide a broader benefit to financial stability and economic growth at this critical juncture in our global history.

I express my sincere thank you to each of our contributors for their time, expertise, commitment and patience in completing this project over a number of years, as well as to our team of INSOL International technical and administrative staff for their efforts in bringing the project to fruition.

I hope you enjoy reading this publication and will find it useful in your future pursuits.

Scott Atkins
President & INSOL Fellow
INSOL International
May 2022

FOREWORD

This book is a special INSOL International publication which explores and evaluates the legal, economic and practical benefits of substantive and procedural consolidation of corporate group restructuring processes in 17 jurisdictions across the globe.

In countries where consolidated group restructuring proceedings are not yet available, the book also explores whether the use of so-called "synthetic" consolidated group proceedings would be admissible under local legislation and could result in similar benefits to actual consolidation for all stakeholders involved. Synthetic, in this sense, is a term used to describe measures put in place to obtain the same or a similar result without following the normal procedure.

In addition to the 18 country contributions, Professor Dr Stephan Madaus from the Martin Luther University Halle-Wittenberg has analysed, in a separate chapter, the impact that the United Kingdom's departure from the European Union (EU) as a result of Brexit may have on established practices concerning the restructuring of international corporate groups, and the future of the United Kingdom as a European hub for global group proceedings.

Empirical studies have shown that, when a company is part of a group, there is a reduced prospect of the company becoming bankrupt in the first place (primarily on the basis of the reallocation of resources and risks across companies in the group, and the increase of debt-bearing capacity and the reduced cost of debt through the provision of intra-group debt guarantees) compared to where entities exist on a standalone basis.[1]

Those same studies show that, if one or more companies in a group do in fact become bankrupt, then the ability to use consolidated group restructuring or bankruptcy procedures can also significantly reduce costs (as compared to using insolvency processes for each individual entity) and therefore increase the potential return to creditors.

In that context, consolidated group restructurings can offer significant economic benefits. In cases where substantive and / or procedural consolidation options are limited, synthetic processes can achieve similar outcomes.

In fact, those very outcomes were achieved on a synthetic basis in the *Collins & Aikman* case, a main proceeding in the United Kingdom that was led by one primary administrator without opening secondary proceedings in the different EU Member States, after making a commitment that creditors in the other EU Member States would be paid dividends in a priority according to their local insolvency laws. The *Collins & Aikman* case resulted in a higher return for all the creditors in the different EU Member States, as compared to what restructuring on the individual legal entity basis would have achieved.

[1] N Dewaelheyns and Prof C Van Hulle, "Corporate Failure Prediction Modelling: Distorted by Business Groups' Internal Capital Markets?" (2006) *Journal of Business, Finance and Accounting*.

The *ratio legis* to this book was also meant to collect materials to support the proposal on consolidated group proceedings made by INSOL Europe on the Revision on the European Insolvency Regulation (EIR) in May 2012.[2] There, the idea was put forward that, regarding groups of companies, the centre of main interests (COMI) of the ultimate parent company ought to be deemed to be the COMI of the subsidiaries. The advantage would have been that, in the event of group insolvency, the court of the COMI would be able to safeguard the coordination of the main insolvency proceedings with respect to all the group companies and, secondly, the latter would in turn safeguard the application of the EIR then (the EIR Recast now) whenever the ultimate group COMI was located outside the EU.

My aspiration with this book is to provide an objective analysis of the current practices in different countries globally in relation to consolidated group restructuring and to make critical comments as to whether, even in the absence of legal options for substantive and procedural consolidated restructuring, synthetic legal group restructuring proceedings could be effectively used to achieve a more beneficial result than general coordination and cooperation procedures used in particular cases.

It is hoped that this book will be a valuable tool for practitioners, academics and the judiciary across the world and that the conclusions reached may serve as the basis for future law reform locally, regionally and globally.

This project would not have been possible without the help and support of many others. The initial acknowledgement must however go to the Technical Research Committee of INSOL International and Dr Sonali Abeyratne, Dr Kai Luck and Ms Waheeda Lafir in particular for all their assistance throughout the completion of the project, Ms Marie Selwood for the English language revision, and of course to all the chapter contributors to the book globally for their time, expertise and commitment. My final thanks go to Mr Neil Cooper, my mentor for over 30 years, who provided me with valuable insights in relation to the *Collins & Aikman* case and taught me to think out of the box and to always try and provide practical solutions to the benefit of all the stakeholders concerned in an insolvency or restructuring proceeding.

Nora Wouters
Dentons Europe LLP, Belgium
May 2022

2 R Van Galen, M Andre, D Fritz, V Gladel, F Van Koppen, D Marks QC and N Wouters, "Revision of the European Insolvency Regulation", Proposal INSOL Europe, 2012, 92-93.

CONTRIBUTORS

Australia	**Lee Pascoe**, INSOL Fellow Norton Rose Fulbright Australia **Jennifer O'Farrell** Dobson Mitchell Allport
Belgium	**Nora Wouters** Dentons Europe LLP
Brazil	**Thomas Benes Felsberg** **Thiago Dias Costa** Felsberg Advogados **Paulo Fernando Campana Filho** Veirano Advogados
Canada	**Jane Dietrich**, INSOL Fellow **Jeffrey Oliver**, INSOL Fellow Cassels Brock & Blackwell LLP
Cayman Islands	**Matthew Goucke**, INSOL Fellow **Niall Hanna** **Siobhan Sheridan** Walkers
France	**Jean Baron**, INSOL Fellow CBFASSOCIES
Germany	**Daniel Arends** Brinkmann & Partner
Hong Kong	**Look Chan Ho** Des Voeux Chambers
Ireland	**Barry Cahir**, INSOL Fellow Beauchamps
Italy	**Rita Gismondi**, INSOL Fellow Gianni & Origoni
Malaysia	**Lee Shih** **Geraldine Goon** Lim Chee Wee Partnership
Singapore	**Sushil Nair** Drew & Napier LLC
South Africa	**Zaheer Cassim**, INSOL Fellow Cassim Inc. Attorneys
Spain	**Adrian Thery** Garrigues **Prof. Iván Heredia** Universidad Autónoma de Madrid & Garrigues

The Netherlands	**Reinout Vriesendorp** **Wies van Kesteren** De Brauw Blackstone Westbroek nv
United Arab Emirates	**Nicola Reader**, INSOL Fellow Clifford Chance LLP
United Kindom	**Elizabeth McGovern**, INSOL Fellow BDO **Colin Cochrane** Reed Smith **Prof. Gerard McCormack** University of Leeds
United States of America	**Jeremy Hollembeak**, INSOL Fellow Baird Holm LLP
Brexit: Implications for Group Restructuring and Insolvency Proceedings	**Prof. Dr. Stephan Madaus** Martin Luther University Halle-Wittenberg, Germany

UNITED STATES OF AMERICA

1. Consolidated group restructurings versus cooperation or coordination procedure*

As a general rule, the United States (US) Bankruptcy Code[1] and US Bankruptcy Rules[2] respect the separateness of each legal entity within a corporate group. A separate petition must be filed for each legal entity within the group (i.e. a debtor) in order for that entity to become the subject of a US bankruptcy case. In turn, a separate US bankruptcy case is opened for each legal entity for which a petition has been filed.[3] Thus, as an example, to place an entire corporate group consisting of 20 affiliated corporate entities into bankruptcy in the United States, 20 petitions would have to be filed, commencing 20 US bankruptcy cases.

However, US bankruptcy cases opened for multiple entities within a single corporate group may be consolidated in two different ways, outlined below.

- **Procedural consolidation (also known as joint administration)**

  Rule 1015 of the US Bankruptcy Rules permits procedural consolidation of the US bankruptcy cases of affiliated entities solely for administrative convenience and efficiency. Joint administration makes it simpler and more cost-effective for debtors and creditors to make, and for US bankruptcy courts to resolve, requests for relief during the cases that impact multiple debtors within the corporate group, for example by consolidating notices, requests for relief and other pleadings from all of the cases onto a single docket.

  Joint administration has *no* substantive impact on the separateness of the entities within a corporate group. The separate assets and liabilities of each debtor (including intercompany claims between members of the corporate group) continue to be recognised and respected.

- **Substantive consolidation**

  In US bankruptcy jurisprudence, "substantive consolidation" refers to a disregard of the corporate separateness between two or more entities within a corporate group, such that their assets are merged together into one common pool to which the creditors of each entity must look to satisfy their claims.[4]

  Although US courts have a long history of granting substantive consolidation under appropriate circumstances, neither the US Bankruptcy Code nor the US

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* Mr Hollembeak is an attorney with Baird Holm LLP with extensive experience representing clients in international litigation and insolvency matters in courts throughout the US. Any views expressed in this chapter are those of the author and not of Baird Holm LLP. US legal ethics rules generally expect attorneys to zealously advocate for their clients, and the author believes he and other US attorneys could advocate positions inconsistent with any views expressed herein.

1 "US Bankruptcy Code" means Title 11 of the USC, 11 USC §§ 101–1532. The US Bankruptcy Code is the statutory law enacted by the US Congress to govern both domestic and cross-border US bankruptcy cases.

2 "US Bankruptcy Rules" means the Federal Rules of Bankruptcy Procedure promulgated by the US Supreme Court.

3 The types of US bankruptcy cases include liquidation cases pursuant to Chapter 7 of the US Bankruptcy Code, reorganisation or structured liquidation cases pursuant to Chapter 11 of the US Bankruptcy Code, and cross border cases pursuant to Chapter 15 of the US Bankruptcy Code.

4 See *FDIC v Colonial Realty Co*, 966 F2d 57, 58 (2d Cir 1992) (substantive consolidation "effects the combination of the assets and the liabilities of distinct, bankrupt entities and their treatment as if they belonged to a single entity").

Bankruptcy Rules explicitly authorises the bankruptcy estate[5] of one debtor to be substantively consolidated with that of another. As a result, the source of authority and proper legal standard for granting substantive consolidation is the subject of some dispute and courts have not applied the relief uniformly. The authority is generally recognised to have originated in US federal common law and been implicitly embodied within certain provisions of the current US Bankruptcy Code.[6]

In the absence of legislative guidance, a number of different, sometimes overlapping judicial, standards have developed among courts in the various US judicial circuits. Each standard, in its own way, ensures that substantive consolidation is granted sparingly. For example, the standard governing bankruptcy cases in Delaware permits substantive consolidation only upon proof that: (i) prior to bankruptcy creditors extended credit in reliance on the corporate group as a whole, rather than on the separate assets and liabilities of individual members of the group; or (ii) the books, records and financial affairs of members of the corporate group are so commingled that untangling them during the bankruptcy would be costly and leave all creditors worse off.[7]

Neither procedural consolidation nor substantive consolidation is automatic. Thus, even where numerous entities in a large corporate group are placed into bankruptcy, the US bankruptcy case of each member of the group will remain separate unless and until consolidation is requested and granted. In practice, procedural consolidation is sought and granted in the vast majority of all corporate group US bankruptcies. By contrast, substantive consolidation is infrequently requested and, especially if opposed by creditors, is even more infrequently granted.

1.1 Corporate group versus individual legal entity

1.1.1 The insolvency and restructuring systems that are in force

The US Bankruptcy Code generally recognises the separateness and independence of distinct legal entities within a corporate group both from each other and from their common owner-entrepreneur.[8] No member of a corporate group is required to open its own US bankruptcy case solely because other members within the same corporate group have done so. Similarly, no subsidiary member in a corporate group is required to open its own US bankruptcy case solely because its parent company or controlling shareholder has done so, and *vice versa*.

Moreover, absent substantive consolidation and with limited exceptions discussed below, the US Bankruptcy Code permits one corporate group member – whether or not itself a debtor subject to its own US bankruptcy case – to participate in the US

[5] Upon the filing of a petition commencing a plenary US bankruptcy case (e.g. a Chapter 7 case or Chapter 11 case but not a Chapter 15 case) a statutory bankruptcy "estate" is created consisting of all assets and rights of the debtor as of the date of the filing: see 11 USC § 541. In Chapter 7 cases, a "trustee" is appointed over this estate. In Chapter 11 cases, while a trustee may be appointed, but in the first instance the authority and obligation to act as a trustee is vested in the debtor itself, which in such capacity is referred to as a "debtor in possession".

[6] The most frequently cited provision of the US Bankruptcy Code is 11 USC § 105(a), which generally authorises relief "necessary or appropriate" to carry out statutory bankruptcy functions.

[7] *In re Owens Corning*, 419 F3d 195, 211 (3d Cir 2005).

[8] See 11 USC §§ 101(41), 109 (defining each individual, partnership and corporation as a separate legal "person" eligible to be a debtor in his / her /its own US bankruptcy case).

bankruptcy case of another group member to the same extent as any unaffiliated creditor or interested party.

Finally, in almost all cases in which it is granted, substantive consolidation only merges the assets and liabilities of affiliated debtors already subject to their own respective US bankruptcy cases. Nevertheless, although a minority of courts have concluded otherwise, most US courts to consider the issue have concluded they have the authority, in appropriate (and rare) circumstances, to substantively consolidate the bankruptcy estate of a debtor with the assets and liabilities of a related non-debtor.[9] The remedy has proved particularly useful in cases where the debtor used non-debtor entities as vehicles to perpetuate a Ponzi scheme or other fraudulent activity.[10]

1.1.2 *Definition of a corporate group*

There is no definition of a "corporate group" under the US Bankruptcy Code.[11] However, the Bankruptcy Code does use the defined terms "affiliate" and "insider" to regulate certain aspects of the bankruptcy process relevant to corporate groups.[12] An affiliate, which generally speaking is any entity with 20% or greater common ownership with the debtor entity in question, is always an insider. Other examples of insiders include the directors and officers of a corporation.

By using these defined terms, certain provisions of the US Bankruptcy Code and the US Bankruptcy Rules can be applied to facilitate certain relief and proscribe certain limitations on corporate group bankruptcies:

- rule 1015 of the US Bankruptcy Rules, which permits a bankruptcy court to order joint administration (i.e. procedural consolidation) of the US bankruptcy cases of two or more debtors who qualify as "affiliates" of one another; and

- section 1129(a)(10) of the US Bankruptcy Code, which requires the votes of "insiders" to be disregarded when determining whether an impaired class of creditors has voted to accept a proposed Chapter 11 plan.

Section 1129(a)(10) strikes a balance between two competing policy interests: on the one hand, corporate separateness should be respected in US bankruptcies and, on the other hand, that respect should not be a means for insider equity owners and

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[9] See for example *In re Mihranian,* 937 F.3d 1214, 1216–17 (9th Cir. 2019) ("Many courts, including this court, permit the substantive consolidation of both debtor and non-debtor entities"), and *In re Stewart,* 571 B.R. 460, 471 (Bankr. W.D. Okla. 2017) ("The Court agrees with the majority of authorities that under very limited circumstances it has the discretion, to be exercised sparingly, to substantively consolidate a debtor's estate with non-debtors"). But see, in contrast, *In re Concepts Am, Inc*, No 14 B 34232, 2018 WL 2085615, at 4–5, 8 (Bankr ND Ill 3 May 2018) (surveying prior decisions addressing the issue, acknowledging in the majority of those decisions that courts have held they have the discretion to order the substantive consolidation of a debtor with a non-debtor, but concluding "non-debtor substantive consolidation is not a remedy available to a court sitting in the Seventh Circuit").

[10] *In re Bonham*, 229 F3d 750, 769 (9th Cir 2000) (approving substantive consolidation of non-debtor entities into estate to allow bankruptcy trustee to pursue avoidance actions against investors who received fraudulent transfers in connection with debtor's Ponzi investment scheme); and see generally also *In re Woodbridge Group of Companies, LLC*, 592 B.R. 761 (Bankr. D. Del. 2018)

[11] As discussed below, the concept of corporate groups has been used to shape many areas of US federal legislation, including pension law, tax law and criminal law. However, as a general matter, the corporate group concept imbedded in those areas of the law has not had a material influence on the application of US bankruptcy law to corporate groups.

[12] 11 USC §§ 101(2) (defining affiliate), 101(31) (defining insider).

control persons to subvert the US Bankruptcy Code's distributional priority scheme, and benefit themselves to the detriment of non-insider creditors. Although section 1129(a)(10) on its face applies only to restructuring plans in Chapter 11 cases, its underlying policy was a key factor in the US Court of Appeals' refusal to enforce a Mexican restructuring plan in the Chapter 15 case of glass-maker Vitro, SAB de CV.[13] As a court examining that decision explained: "[t]he *Vitro* plan created only a single class of unsecured creditors and the necessary creditor votes to approve the plan were only achieved by counting the votes of insiders" – specifically the votes of Vitro's non-debtor subsidiaries which held large intercompany claims against their parent debtor.[14]

Because insider votes are not counted toward plan approval under section 1129(a)(10) of the US Bankruptcy Code, Vitro's Mexican plan "could not have been approved" if it were subject to the policy limitations imposed by that section on corporate group restructurings in Chapter 11.[15] As a result, the Court of Appeals concluded that the bankruptcy court did not abuse its discretion in refusing to grant comity and enforce the Mexican plan.[16]

1.1.3 Legislation relating to corporate groups

The author is not aware of any pending draft US legislation on this issue.

The concept of a "group" does appear in the recently enacted Small Business Reorganization Act of 2019, which came into effect on 19 February 2020 and added Subchapter V (11 U.S.C. §§ 1181-1195) to Chapter 11 of the US Bankruptcy Code. Chapter 11 had long been criticised as a poor one-size-fits-all restructuring regime that is too complex, time-consuming and costly for most individuals and small businesses to effectively reorganise.

Subchapter V is intended to mitigate the perceived challenges Chapter 11 posed for small business debtors by streamlining the reorganisation plan process and limiting the extent to which creditors can participate and vote down a plan relative to typical Chapter 11 cases. To prevent large debtors from taking advantage of the new law, Subchapter V was made available only to debtors with no more than US $3,024,725 in aggregate secured and unsecured non-contingent debt.[17] Moreover, to prevent large corporate groups from circumventing this requirement, new section 1182(1)(B)(i) of the US Bankruptcy Code also made Subchapter V unavailable to any debtor which itself had less than the statutory maximum but was a "member of a group of affiliated debtors that has aggregate noncontingent liquidated secured and unsecured debts in an amount greater than US $3,024,725 (excluding debt owed to 1 or more affiliates or insiders)." As a result, exceedingly few corporate groups (i.e. only those with less than

[13] *In re Vitro SAB de CV*, 701 F3d 1031, 1069 (5th Cir 2012).
[14] *In re Agrokor dd,* 591 BR 163, 173 (Bankr SDNY 2018).
[15] *Ibid.*
[16] *Idem*, 189.
[17] 11 USC §§ 1182(1)(A) (defining who can be a Subchapter V "debtor"). As originally enacted in 2019, the statutory maximum debt amount was US $2,725,625. That amount was increased to US $7,500,000 on March 27, 2020 for a period of two years, as part of the CARES Act legislation enacted to provide various relief in response to the COVID-19 pandemic. The increased debt limit under the CARES ACT ended on March 27, 2022. Although efforts in Congress are ongoing to reinstate the US $7.5 million debt limit, as of May 3, 2022 the debt limit, due to inflationary increases, was US $3,024,725.

US $3,024,725 of indebtedness in the aggregate) will be able to use Subchapter V to restructure in lieu of a full Chapter 11 case.[18]

1.2 Corporate group versus individual corporate benefit

1.2.1 The existence and relevance of "corporate group benefits"

As indicated above, the default rule under US bankruptcy law is to respect the separateness of corporate group entities by opening and maintaining a separate US bankruptcy case for each entity that, absent affirmative relief, will be administratively and substantively separate from the cases of other group members. Concepts akin to a "corporate group benefit" are explicit in some US statutory frameworks,[19] but not the US Bankruptcy Code or US Bankruptcy Rules.

Nevertheless, the concept does seem to have a practical influence in US bankruptcies. For example, oftentimes US bankruptcy courts presiding over corporate group cases will issue rulings about whether requested relief is in the best interests of the consolidated debtor group without making specific determinations with respect to the interests of each individual debtor's bankruptcy estate. By objecting, however, a creditor of one debtor in the corporate group can typically force the bankruptcy court to make such a determination before imposing relief that will permanently alter the assets and / or liabilities of that particular debtor. In turn, when determining the overall benefit or burden posed by requested relief on a particular debtor's estate, bankruptcy courts will sometimes account for an indirect benefit to or burden on the estate if relief directly impacting other debtors or the corporate group as a whole is granted. Absent substantive consolidation, whether and to what extent an indirect corporate group benefit (or burden) should be considered is not entirely clear from prior US bankruptcy case decisions. This has led to various attempts by parties to modern structured financing arrangements to supply more clarity by contract.

One context in which the concept of "corporate group benefit" frequently comes into play is US bankruptcy-related litigation concerning whether upstream guarantees made by operating subsidiaries can be avoided as constructively fraudulent transfers.[20] Financially distressed corporate groups often enter US bankruptcy having recently incurred significant financial indebtedness they can no longer service. Commonly, this group financing has been structured so only one or two corporate group members is the actual borrower, such as the group's parent or an intermediate holding company. As credit support, the subsidiaries in the corporate group, whose primary or only asset is stock ownership of other group members, will guarantee the

[18] Further discussion of Subchapter V is beyond the scope of this chapter.

[19] For example, the Employee Retirement Income Security Act (or "ERISA") is a federal law that governs employee pension plans in private industry and sets standards for how corporate group employers must operate pension and other benefit plans for employees of different group members. Similarly, the Internal Revenue Code's tax consolidation regime permits groups of commonly controlled corporations to file consolidated returns as a single taxpayer, thereby ignoring intercorporate distinctions and permitting the common parent to file on behalf of the members. In addition, the Racketeering Influenced and Corrupt Organizations Act (or "RICO") provides enhanced criminal and civil penalties for acts performed by or on behalf of a criminal enterprise, which can include a corporation or group of corporate entities.

[20] Specifically, regardless of intent, transactions can be avoided as "constructively fraudulent" if the debtor received less than reasonably equivalent value in connection with the transaction. Generally, if the debtor was insolvent at the time of the transaction, or rendered insolvent thereby, and did not receive reasonably equivalent value, the trustee of a US bankruptcy estate can "avoid" (i.e. unwind) the transaction: see 11 USC § 548(a)(1).

borrower's repayment obligations (i.e. upstream guarantees) and pledge substantially all of their assets as collateral securing the those guarantees.

One benefit of upstream guarantees and liens from the perspective of the lenders receiving them is the potential, in a bankruptcy scenario, to assert a claim for the entire amount of the indebtedness against the assets and estate of each corporate group member. Left unchecked, lenders could use this structure to dilute and marginalise the corporate group's other creditors who typically have unsecured claims against only one corporate group guarantor. US bankruptcy law does provide some checks, however, including the ability of a bankruptcy estate representative (typically a trustee or creditors' committee) to seek avoidance of the upstream guarantee obligations as constructively fraudulent.

If successful, such an avoidance action should limit the amount of the guarantee claim and lien that financing lenders can assert against the estate of any individual corporate group debtor to the amount of value that specific debtor actually received as a result of the group financing.[21] The parties will have divergent views about whether and to what extent subsidiary guarantors received value in the form of a corporate group benefit. The party attacking the transaction typically takes the position that the value received by each subsidiary guarantor must be limited to direct benefits it received, including the exact dollar amount of proceeds from the financing that was "downstreamed" by the parent borrower to fund the subsidiary guarantor's operations or satisfy its pre-existing liabilities.

By contrast, lenders hoping to shield their upstream guarantees from avoidance as much as possible typically argue each subsidiary guarantor, in addition to directly benefiting from downstreamed financing proceeds, also benefited indirectly from the overall benefit that the financing provided to the corporate group as a whole.

Whether a US bankruptcy court will recognise these indirect "corporate group benefits" is highly dependent upon the underlying circumstances in each case. US common law addressing the issue generally lacks clear and consistent guidelines for financial lenders to rely on in predicting whether their bargained for guarantees from the subsidiary members of a corporate group will be respected in a US bankruptcy.[22]

To minimise this uncertainty, so-called "savings clauses" have become a market feature of guarantee agreements in major US corporate financings. Generally speaking, a savings clause caps the size of the upstream guarantee each subsidiary provides in connection with a corporate group financing at the maximum amount of indebtedness that the subsidiary is able to incur without being rendered insolvent.

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[21] The US Bankruptcy Code provides transferees of constructive fraudulent transfers a defence to the extent they provided their debtor with value in good faith in exchange for the assets transferred or obligations incurred: see 11 USC §§ 548(c), 550(b). Thus, unless they lacked good faith, lenders' exposure to avoidance of their upstream guarantee with respect to any subsidiary guarantor should be limited to the difference between the amount guaranteed and the amount of value (if any) of the financing provided to the guarantor.

[22] Cf. *In re TOUSA, Inc*, 680 F3d 1298 (11th Cir 2012) (avoiding certain liens granted by corporate subsidiaries to lenders as security for loan to corporate parent, finding that the subsidiaries did not receive reasonably equivalent value for the liens) with *In re PSN USA, Inc*, No. 02-11913-BKC-AJC, 2011 WL 4031147, *6 (Bankr SD Fla 9 September 2011) (holding that a parent and subsidiary may share an "identity of interest" such that any benefit the parent receives may form the basis for a finding of reasonably equivalent value at the subsidiary level); see also *In re Sabine Oil & Gas Corp*, 547 BR 503, 547 (Bankr SDNY 2016) (holding that "the question of whether indirect benefits, whether received by entities as members of a single enterprise or otherwise, can constitute reasonably equivalent value for a guarantee is a question of fact").

Thus, where a subsidiary guarantor's upstream guarantee and supporting pledge of assets in the entire amount of a corporate group financing would render it insolvent and thereby subject the guarantee and pledge to avoidance as constructively fraudulent, an effective savings clause circumvents this result by limiting the amount of the financing parties' guarantee claim and lien against the subsidiary to only that portion of the financing that can be asserted without triggering avoidance exposure.[23] In practice, that amount is not determined unless and until the guarantee is called upon, and then is often hotly contested. Part of that dispute is whether and to what extent each subsidiary guarantor indirectly shares in a corporate group benefit from the financing.

1.2.2 Director liability

Unlike in a number of other jurisdictions, US business entities are not required to cease operations or commence US bankruptcy proceedings to restructure or wind up once they become insolvent. Moreover, directors and officers of these entities generally are not subject to liability for operating an insolvent business – that is, neither corporate law nor bankruptcy law in the US recognises a right to sue directors and officers for "trading while insolvent".[24] Thus, when a US corporate entity becomes insolvent, directors and officers have substantially the same liability exposure as they did when the entity was solvent. That exposure generally is limited to circumstances in which a director or officer breaches one of their fiduciary duties, such as the duty of care or the duty of loyalty. In short, directors and officers of US corporate entities are protected by a highly deferential legal regime in which their exposure to personal liability resulting from the insolvency of the business is the rare exception rather than the rule.

The US Bankruptcy Code and US Bankruptcy Rules respect and enforce applicable corporate law, which is the law of the state of the debtor entity's incorporation. Under state law, directors and officers owe fiduciary duties only to the entity for which they serve as director or officer. They owe no duties to any subsidiary or other affiliate of such an entity unless they also simultaneously serve as a director or officer of that subsidiary or affiliate.[25] Accordingly, corporate group benefit generally has no impact on directors' and officers' liability.

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[23] *In re Exide Tech, Inc*, 299 BR 732, 748 (Bankr D Del 2003) (noting that the savings clause "saves a portion of a transfer of collateral that might be avoided in its entirety if a Court deems the transfer to violate the fraudulent transfer or conveyance laws"). See generally also *In re Capmark*, 438 BR 471 (Bankr D Del 2010) (providing examples of form "savings clauses").

[24] Although there is some case law suggesting the existence of a state-law tort referred to as "deepening insolvency", US bankruptcy courts have generally refused to hold directors and officers liable for these types of claims without an independent showing that they breached their fiduciary duties to the debtor for which they serve. See *In re Verestar, Inc*, 343 BR 444, 476 (Bankr SDNY 2006) ("Unlike some foreign jurisdictions, where the law imposes liability on directors who continue to trade after the corporation becomes insolvent, under American law there is no duty to liquidate, untempered by the business judgment rule, upon insolvency") (citations omitted); see also *Fehribach v Ernst & Young LLP*, 493 F3d 905, 909 (7th Cir 2007) ("[T]he theory [of deepening insolvency] makes no sense when invoked to create a substantive duty of prompt liquidation that would punish corporate management for trying in the exercise of its business judgment to stave off a declaration of bankruptcy, even if there were no indication of fraud, breach of fiduciary duty, or other conventional wrongdoing").

[25] See *Trenwick Am Litig Trust v Ernst & Young, LLP*, 906 A2d 168, 191-92 (Del Ch 2006) ("Under settled principles of Delaware law, a parent corporation does not owe fiduciary duties to its wholly-owned subsidiaries or their creditors"). Unlike some non-US jurisdictions, US state law does not recognise a liability claim for fiduciary breach against a shareholder, director or officer of an affiliate of the debtor in a corporate group on the basis that he or she acted as a *de facto* or shadow director of the debtor itself. See e.g. *In re Nortel Networks, Inc*, 469 BR478, 499–505 (Bankr D Del

1.2.3 *"Early warning systems"*

US securities laws and regulations require all public and many private companies to produce periodic financial statements prepared by management and analysed by independent auditors in compliance with US generally accepted accounting principles (GAAP). Financial statements that comply with US GAAP are prepared under the assumption that the subject company will continue to operate as a going concern, and a company must disclose if adverse conditions or events cause its management or auditor substantial doubt whether it will be able to continue operations for the 12 months following the date of a statement. Further details of such "going concern" disclosures are beyond the scope of this update, but they could be characterised as a type of "early warning system" to shareholders and the investing public of a company's distressed financial condition and the increased likelihood of its insolvency.

However, US law does not impose any requirements on directors of individual legal entities to warn their corporate group parent of financial distress or to prepare restructuring or other contingency plans above and beyond what may be required of management to comply with its fiduciary duties to shareholders. Moreover, it is not clear additional early warning systems would be helpful. In practice, it is exceedingly rare for a US corporate group's slide into distress and bankruptcy to take its stakeholders or the marketplace by surprise.

1.2.4 *Pending or draft legislation*

The author is not aware of any pending or draft legislation concerning this issue.

1.3 Universalism versus territorial principle

1.3.1 *Application of the modified universalism rules*

Chapter 15 of the US Bankruptcy Code is based on and substantially incorporates (with relatively minor deviations) the United Nations Commission on International Trade Law Model Law on Cross-Border Insolvency (Model Law) and is generally recognised to embrace the principles of "modified universalism".[26] In particular,

2012) (analysing and ultimately dismissing breach claims against a debtor for allegedly acting as *de facto* or shadow directors of its sister company under English, Irish and French – but not US – law). However, the same conduct that would support such a claim under foreign law may be sufficient to support cognisable claims under US state law for aiding and abetting a breach of fiduciary duty by the debtor's actual director: ibid *Nortel* 510–11 (ruling same basic allegations that were pled in support of *de facto* or shadow director claims under English, Irish and French law were sufficient to support claims under Delaware and Texas law for aiding and abetting breaches of fiduciary duty committed by directors of debtor's sister company). Beyond aiding and abetting liability, and only in the most extreme circumstances where influence or control is pervasive, liability claims against a shareholder, director or officer of an affiliate of the debtor in a corporate group may succeed under "piercing the corporate veil" or "fundamental fairness" jurisprudence. See HvJ Miguens, "Liability of a Parent Corporation for the Obligations of an Insolvent Subsidiary Under American Case Law and Argentine Law" (2002) *10 American Bankruptcy Institute Law Review* 217, 220-228 (discussing the small number of American case decisions in which liability was imposed and observing "[i]n contrast with the foregoing decisions imposing liability on the parent of the insolvent subsidiary, trustees in bankruptcy and creditors of an insolvent subsidiary (or controlled corporation) have been unsuccessful in their efforts to impose liability upon the parent corporation (or controlling shareholder) in the overwhelming majority of cases").

[26] See *In re ABC Learning Centres Ltd*, 728 F3d 301, 306 (3d Cir 2013) ("Chapter 15 embraces the universalism approach"); J L Westbrook, "Chapter 15 At Last" (2005) 79 *American Bankruptcy Institute Law Review* 713, 715.

Chapter 15 adopts procedures in the Model Law for both inbound and outbound ancillary proceedings:

- *Inbound*

  Sections 1504 and 1515 of the US Bankruptcy Code enable the representative of a foreign (non-US) insolvency proceeding to open a Chapter 15 case (i.e. a US ancillary proceeding) by filing a petition for recognition of the foreign proceeding.[27] Assuming the petition is granted, the foreign representative may access a broad range of relief intended to facilitate outcomes that embody modified universalism. For example, section 1521 of the US Bankruptcy Code, based on article 21 of the Model Law, authorises the foreign representative to request a suite of statutory remedies, including the ability to protect, collect and repatriate for distribution in the foreign proceeding those assets of the foreign debtor located within the US (a universalist outcome).[28] However, the US bankruptcy court may scrutinise the request and deny it unless "the interests of the creditors and other interested entities, including the debtor, are sufficiently protected"[29] – a test that has been used on occasion to deny universalist outcomes;[30] and

- *Outbound*

  Section 1505 of the US Bankruptcy Code, which largely incorporates article 5 of the Model Law, authorises the US bankruptcy court to enable certain representatives of a US bankruptcy case to open ancillary proceedings and act on behalf of the plenary bankruptcy estate in foreign jurisdictions.[31] Subject to limitations imposed by the US court (if any), the appointed representative may act in any way permitted by applicable foreign law.[32]

1.3.2 *Bilateral and / or multilateral treaties in force*

The primary regulation of ancillary proceedings in the US is the statutory scheme of Chapter 15 of the US Bankruptcy Code. The US is a common law legal system, and, therefore, case law is an important secondary source of authority for the application of

[27] 11 USC §§ 1504 and 1515.
[28] 11 USC § 1521.
[29] 11 USC § 1522.
[30] See e.g. *Jaffe v Samsung Elec Co, Ltd*, 737 F3d 14 (4th Cir 2013) (denying request of foreign representative to enforce German insolvency court's order granting relief expressly prohibited in US plenary bankruptcy cases by US bankruptcy statute, holding that US bankruptcy courts "may only grant discretionary relief under [11 USC] § 1521 if it determines that 'the interests of the creditors and other interested entities, including the debtor, are sufficiently protected'") (quoting 11 USC § 1522(a)); see also *In re Vitro SAB de CV*, 701 F3d at 1060 (finding, in *dicta*, that even if §1521 of the US Bankruptcy Code authorised enforcement of non-consensual third-party releases contained in the Mexican reorganisation plan, § 1522 would prohibit such enforcement).
[31] See 11 USC § 1505. Unlike art 5 of the Model Law, § 1505 of the US Bankruptcy Code requires the trustee or entity acting on behalf of the US bankruptcy estate to obtain US court approval prior to acting abroad.
[32] US bankruptcy courts routinely permit a debtor-in-possession to act as the foreign representative of the estate in a foreign proceeding when necessary to protect the value of the debtor's estate and assets. See for example *In re Purdue Pharma L.P.*, No. 19-23649 (RDD) (Bankr. S.D.N.Y. Sept. 18, 2019) [Docket No. 70]; *In re TK Holdings Inc., et al*. [U.S. subsidiaries of Japanese airbag manufacturer Takata], No. 17-11375 (BLS) (Bankr. D. Del. June 27, 2017) [Docket No. 114]; *In re Cal Dive International, Inc*, No 15-10458 (CSS) (Bankr D Del 6 March 2015) [Docket No 61]; *In re Allied Sys Holdings, Inc*, No 12-11564 (CSS) (Bankr D Del 12 June 2012) [Docket No 97]; *In re TerreStar Networks Inc*, Case No 10-15446 (SHL) (Bankr SDNY 20 October 2010) [Docket No 30].

modified universalism in Chapter 15 cases. The US is not currently party to any bilateral or multilateral treaties with other countries concerning cross-border insolvency proceedings.

1.3.3 Pending legislation

The author is not aware of any upcoming legislative changes concerning this issue.

1.4 Competent court and applicable law

US federal district courts have exclusive and original subject matter jurisdiction over cases arising under the US Bankruptcy Code, including both plenary and ancillary (i.e. cross-border cases).[33] In practice, the district courts refer both types of cases and certain related disputes to specialised bankruptcy courts within each federal district.[34]

Ancillary Chapter 15 cases are commenced by the filing of a petition seeking recognition in the US of an insolvency proceeding pending in a non-US jurisdiction (i.e. a foreign proceeding). Only a duly-authorised representative of the foreign proceeding in question (i.e. its foreign representative) is permitted to file a petition commencing a Chapter 15 case. Thus, neither the debtor subject to the foreign proceeding nor any of its creditors have direct authority to commence a Chapter 15 case. That said, it is not uncommon for corporate group debtors and their creditors to agree as a condition to implementation of a foreign restructuring plan that a Chapter 15 case must be opened and the appointed foreign representatives must obtain an order from the US bankruptcy court enforcing the foreign plan within the US.

By contrast, plenary Chapter 7 or 11 bankruptcy cases for members of a corporate group may be initiated voluntarily by each debtor’s management or involuntarily (i.e. without support of the debtor entity in question) by three or more creditors holding unsecured claims of at least US $18,600 in the aggregate that are not contingent as to liability or subject to a bona fide dispute as to either liability or amount.[35] Unlike when a debtor files a voluntary petition, which causes a bankruptcy case to be opened automatically, a bankruptcy case commenced by creditors will not be opened until their involuntary petition is granted by the US bankruptcy court upon a determination that either: (1) the debtor is not generally paying its debts as they become due; or (2) a trustee or receiver was appointed over some portion of the debtor’s property within 120 days before the petition.[36]

By statute, the proper venue for a Chapter 15 case isthe bankruptcy court in the US District: (1) in which the debtor has its principal place of business or principal assets in the United States; (2) if the debtor does not have a place of business or assets in the United States, in which there is pending against the debtor an action or proceeding in a Federal or State court; or (3) in a case other than those specified in paragraphs (1) and (2), in which venue will be consistent with the interests of justice and the convenience of the parties, having regard to the relief sought by the foreign representative.[37]

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[33] 28 USC § 1334(a).
[34] 28 USC § 157(a).
[35] 11 USC § 303(b).
[36] 11 USC § 303(h).
[37] 28 USC § 1410.

Thus, in the first instance the competent court to preside over a Chapter 15 case will be dictated by the location of a foreign debtor's business and assets in the US. Notwithstanding paragraphs (2) and (3) above, which appear to provide for proper venue of a Chapter 15 case involving a debtor with no business or assets in the US, the US Court of Appeals for the Second Circuit has ruled, in a decision binding on all New York bankruptcy courts and followed as persuasive authority by courts in other federal circuits, a foreign debtor is not eligible to be subject to a Chapter 15 case unless it has a domicile, place of business or property in the US.[38] To comply with this requirement in circumstances where the foreign debtor has no existing business or assets in the US, prior to filing a petition foreign representatives often open a retainer account with their Chapter 15 counsel at a bank located in the district they wish to file and place debtor funds in that account.[39] Thus, in most Chapter 15 cases, including corporate group cases, the petitioning foreign representative effectively can choose which US district can preside over its Chapter 15 case.

Different rules provide similar flexibility in determining where a corporate group restructuring will proceed in a plenary Chapter 11 case. A plenary case may be opened in any US district in which the subject debtor entity has had its principal place of business or principal assets in the US for the 180 days prior to the commencement of such case.[40] In the specific context of corporate group restructurings, once a Chapter 11 case is properly opened by one member of the debtor group in a particular US district, a separate case may thereafter be opened in that same US district for any "affiliate"[41] of the first debtor within the corporate group, regardless of whether the affiliate has a place of business or assets in that district.[42] This statutory mechanism allows many large distressed enterprises with headquarters and operations throughout the US or internationally to open Chapter 11 bankruptcy cases for their entire corporate group before a single US bankruptcy court. In practice, many corporate group debtors use this mechanism to open bankruptcy cases in select jurisdictions, such as Delaware or the Southern District of New York, despite having little or no connection to the jurisdiction other than having incorporated one or more group members there. Some US lawmakers and practitioners have criticised this practice as easy to manipulate, often resulting in Chapter 11 cases for a corporate group proceeding in a bankruptcy court far away from the employees, non-financial creditors (e.g. vendors and landlords), and surrounding communities most impacted by its financial distress and efforts to reorganise. To date, however, all attempts to change the law and force corporate groups to go through Chapter 11 in the jurisdiction where their headquarters or primary assets and operations are located have failed.

This practice in Chapter 11 cases creates interesting contrasts with Chapter 15 cases involving corporate groups, in which the location of any group member's headquarters, primary assets or majority creditors outside the jurisdiction of the

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[38] *Drawbridge Special Opportunities Fund LP v Barnet (In re Barnet)*, 737 F.3d 238 (2d Cir. 2013) (applying "debtor" requirements for plenary bankruptcy cases in 11 USC § 109(a) to ancillary Chapter 15 cases).

[39] See for example *In re Berau Capital Resources Ptd Ltd*, 540 B.R. 80, 81-82 (Bankr. S.D.N.Y. 2015) (section 109(a) satisfied by attorney retainer account, and also by debtor contract rights located in New York as a result of debtor being obligor on over $450 million of U.S. dollar denominated debt over which New York law expressly governs in debt indenture which also included New York choice of forum clause).

[40] 28 USC § 1408(1).

[41] For the US Bankruptcy Code's definition of "affiliate," see the discussion above. See also 11 USC § 101(2).

[42] 28 USC § 1408(2).

foreign proceeding for which Chapter 15 recognition is sought can limit the relief available from the US bankruptcy court. A Chapter 15 case must seek recognition of the subject foreign proceedings as either a "foreign main proceeding" – i.e. a proceeding pending in the country where the debtor has its centre of main interests (COMI) – or a "foreign non-main proceeding" – i.e. a proceeding in a country where the debtor has an establishment but not its COMI.[43]

In the case of corporate groups, a determination of COMI is separately made for each foreign debtor in the group regardless where the group operates as a whole or the sequence in which Chapter 15 petitions for each group member were filed.

Moreover, although the foreign jurisdiction where each debtor's registered office is located is statutorily presumed to be its COMI, that presumption can be rebutted by consideration of the very factors arguably ignored in the Chapter 11 context, including the location of the debtor's headquarters, primary assets, employees and other creditors.

As a result, achieving recognition and enforcement in the US of a foreign proceeding and plan of reorganisation for a corporate debtor group involving numerous affiliates registered and doing business in various international jurisdictions can be much more challenging than confirming a Chapter 11 plan under similar circumstances. An example of this played out recently in the Constellation Group restructuring decisions in which the corporate group ultimately implemented a Brazilian restructuring plan that was recognised and enforced in the US through Chapter 15 cases, but only after several false starts and re-filings on behalf of certain foreign debtor affiliates which were registered and found to have their COMI outside of Brazil.[44]

1.4.1 *Applicable law that falls outside of the* lex fori concursus *and related issues*

US bankruptcy law purports to apply globally in plenary cases – to all creditors and property of a bankruptcy estate, wherever located.[45] The courts have recognised that the "bankruptcy court's *in rem* jurisdiction is broad and reaches property wherever located", and that Congress "explicitly gave bankruptcy courts global reach over the debtor's property".[46] Pursuant to its broad jurisdiction over the bankruptcy estate, a US bankruptcy court may prohibit creditors from seeking remedies or adjudication of their claims in foreign jurisdictions when doing so would conflict with the bankruptcy

[43] See 11 USC §§ 1517 and 1502(4)–(5); see also 11 USC § 1502(2) (defining "establishment" as "any place of operations where the debtor carries out a non-transitory economic activity"). US courts have held that a debtor's COMI should be determined as of the time the Chapter 15 petition is filed, rather than as of time the foreign proceeding is initiated, but "[t]o offset a debtor's ability to manipulate its COMI, a court may also look at the time period between the initiation of the foreign liquidation proceeding and the filing of the Chapter 15 petition": see *In re Fairfield Sentry Ltd*., 714 F.3d 127, 133 (2d Cir. 2013).

[44] *In re Serviços De Petróleo Constellation S.A., et al*., 600 B.R. 237 (Bankr. S.D.N.Y. 2019); *In re Serviços De Petróleo Constellation S.A., et al*., 613 B.R. 497 (Bankr. S.D.N.Y. 2020); and *In re Olinda Star Ltd*., 614 B.R. 28 (Bankr. S.D.N.Y. 2020).

[45] See 28 USC § 1334(e) (providing US courts with jurisdiction over "all the property, wherever located, of the debtor" in a Chapter 11 bankruptcy case); 11 USC § 541(a)(1) (property of the bankruptcy estate includes "all legal or equitable interests of the debtor in property as of the commencement of the case … wherever located and by whomever held").

[46] *In re Lehman Bros Holdings, Inc*, 535 B.R. 608, 628 (Bankr SDNY 2015); see also *Hong Kong & Shanghai Banking Corp, Ltd v Simon (In re Simon)*, 153 F3d 991, 996 (9th Cir 1998) ("Congress intended extraterritorial application of the Bankruptcy Code as it applies to property of the estate").

court's adjudication of the issues before it and may punish creditors violating such orders.[47]

Notwithstanding their broad jurisdiction, US bankruptcy courts may decline to hear disputes that are subject to the jurisdiction of foreign bankruptcy proceedings on the grounds of comity.[48]

Although US bankruptcy courts do have subject matter jurisdiction to resolve disputes concerning any of a debtor's property located in foreign jurisdictions, the practical impact of their orders is limited when property is located outside of US borders and under the custody and control of individuals or businesses that are (and intend to remain) beyond the reach of US law enforcement.

1.4.2 Harmonisation of substantive restructuring and insolvency laws

With respect to cross-border cases inbound to the US, the harmonisation of insolvency laws would arguably be beneficial. From the perspective of a US creditor, savvy corporate groups may be able to strategically leverage the general inclination of US courts to respect non-US insolvency proceedings to sidestep creditor protections in US bankruptcy law that are reduced or absent altogether in the insolvency laws of other jurisdictions by steering a corporate group restructuring to those other jurisdictions. Therefore, the argument goes, greater consistency between the substantive restructuring and insolvency laws of the US and those other jurisdictions would result in fewer opportunities to disadvantage US creditors.

For example, at the time of the *Vitro* case discussed above, the use of intercompany claims to mass voting majorities required for court approval of corporate group restructuring plans was not precluded under Mexican insolvency law.[49] After that case concluded, amendments to Mexican insolvency law aimed at prohibiting corporate group restructurings in this manner ostensibly brought it more in line with the US

[47] See *In re MF Global Holdings Ltd*, Case No. 11-15059 (MG) 2017 WL 119140, at *8 & n10 (Bankr SDNY 12 January 2017) (holding that Bermuda-based insurers violated the bankruptcy court's temporary restraining order when the insurers obtained an order from a Bermuda court enjoining US-based plaintiffs from pursuing adjudication of their claim in the Chapter 11 case, and noting that the court would consider holding the insurers in contempt, "with possible sanctions including striking their pleadings and entering a default"); *Lyondell Chem Co v CenterPoint Energy Gas Servs Inc* (*In re Lyondell Chem Co*), 402 BR 571, 575 (Bankr SDNY 2009) (enjoining, for a period of 60 days, the debtor's creditors from pursuing remedies, including the commencement of involuntary insolvency proceedings in foreign countries, against the debtor's non-debtor parent); and see also Order Confirming First Amended Joint Plan of Reorganization, *In re Scrub Island Development Group Ltd*, No 13-15285-MGW, 2015 WL 1132792 (Bankr MD Fla) at *17 (ordering the debtors' lender to dismiss, with prejudice, a receivership proceeding commenced by the lender with respect to the debtors' assets located in the British Virgin Islands).

[48] See *JP Morgan Chase Bank v Altos Hornos de Mexico, SA de CV*, 412 F.3d 418, 424 (2d Cir 2005) (noting that international comity involves "the discretion of a national court to decline to exercise jurisdiction over a case before it when that case is pending in a foreign court with proper jurisdiction" and observing that "US courts should ordinarily decline to adjudicate creditor claims that are the subject of a foreign bankruptcy proceeding" because in those cases "deference to the foreign court is appropriate so long as the foreign proceedings are procedurally fair and … do not contravene the laws or public policy of the [US]").

[49] At trial before the US Chapter 15 court, Vitro introduced uncontroverted evidence that numerous prior Mexican corporate group restructurings had been effectuated in this manner and the court, after noting objecting creditors were active participants in the Mexican main proceedings, refused to entertain their arguments that Mexican law had been violated: see *In re Vitro, SAB de CV*, 473 B.R. 117, 130–131 (Bankr ND Tex), *aff'd sub nom* See *In re Vitro SAB de CV*, 701 F.3d 1031 (5th Cir 2012).

Bankruptcy Code.[50] It is unclear whether this amendment has prevented significant subsequent US litigation on this issue concerning Mexican corporate group restructurings.[51]

With respect to cross-border cases outbound from the US, harmonisation may be less impactful generally. US bankruptcy courts employ an expansive definition of personal jurisdiction including over many individuals and businesses located, domiciled or incorporated outside the US so long as they have certain "minimum contacts" with the US.[52] Thus, for example, individuals wishing to travel to the US or corporate groups wishing to borrow money or conduct business in the US are likely to comply with a US bankruptcy court order even if the same order could not be obtained under substantive law in their home jurisdiction. As a result, in most cases US restructurings can be enforced as a practical matter even without assistance from non-US courts.[53]

That said, differences between the powers to avoid and clawback pre-bankruptcy transfers under US law (which are very broad) and under the laws of other jurisdictions have been the source of much US litigation in recent years, particularly in Ponzi scheme bankruptcies that spread outside the US. Until recently, multiple lower court decisions arising out of the *Madoff* US bankruptcy case held that payments received by transferees that had invested with Madoff through off-shore feeder funds could not be clawed back under US law where those funds themselves were subject to insolvency proceedings in their jurisdictions of incorporation (such as the British Virgin Islands). The reasoning was that US courts, as a matter of international comity, should abstain from seeking to clawback the same payments that foreign liquidators may be able to clawback for the benefit of creditors in the non-US proceedings of the feeder funds. Arguably, the effect of those decisions was to insulate many investor payments from any clawback exposure at all because of the limited clawback powers available under governing law in the feeder fund offshore proceedings. Notwithstanding, those decisions were recently reversed on appeal[54] and, unless and until avoidance and clawback laws are harmonised, litigation in cross-border cases between those hoping to apply US law and those hoping to avoid its broad application is likely to continue.

1.4.3 Relevant treaties or case law

As indicated above, Chapter 15 of the US Bankruptcy Code permits foreign representatives to seek the assistance of US bankruptcy courts to recover property of the foreign debtor located in the US and to enforce judgments issued in the foreign proceeding. Chapter 15 encourages courts to follow "principles of comity and cooperation with foreign courts in deciding whether to grant" enforcement of foreign court orders.[55] After recognition is granted under Chapter 15, the foreign

[50] See January 2014 amendments to Article 157 of *Ley Concursos de Mercantiles*.
[51] The *Vitro* decision itself, which predated these amendments, likely had the same impact.
[52] See Fed R Bankr Pro 7004(f); Fed R Civ P 4(k); *In re Uni-Marts, LLC*, 405 B.R. 113, 121-22 (Bankr D Del 2009); *In re Bernard L Madoff Investment Securities LLC*, 418 BR 75 (Bankr SDNY 2009) (finding that Swiss account holders had sufficient minimum contacts with the US to support the bankruptcy court's personal jurisdiction over them where they conducted financial transactions to and from New York bank accounts and sent correspondence to the US concerning transfers from New York accounts).
[53] See *MF Global Holdings Ltd*, 2017 WL 119140, at *8 (observing that, even if the US bankruptcy court's judgment against Bermuda-based insurers was not recognised by a Bermudian court, "the Bermuda Insurers write insurance policies for and collect premiums from companies in New York and the United States, so the Plaintiffs may well have recourse to recover on any judgment obtained in the United States, if that eventuality comes to pass").
[54] These decisions were recently reversed. See *In re Picard, Tr for Liquidation of Bernard L Madoff Inv Sec LLC*, 917 F3d 85, 103–105 (2d Cir 2019).
[55] *In re Metcalfe & Mansfield Alternative Investments*, 421 B.R. 685, 696 (Bankr SDNY 2010); see also 11

representative may seek "additional assistance" from the US court to enforce the results of the foreign insolvency proceeding within the US.[56]

In determining whether to offer such assistance, the US court must consider, "consistent with the principles of comity", whether enforcing the order would reasonably assure just treatment of all claimants, protection of US claimants from prejudice and inconvenience in the processing of claims in the foreign proceeding, and prevention of fraudulent dispositions of the debtor's property.[57] In practice, courts tend to focus on whether the foreign proceeding was procedurally fair.

Although US bankruptcy courts have discretion to refuse to enforce a foreign order because it grants substantive relief unavailable under US law,[58] to date they have exercised that discretion sparingly and typically enforce such orders.[59]

1.4.4 Upcoming new legislation

The author is not aware of any upcoming legislative changes concerning this issue.

2. Substantive consolidated restructuring proceedings versus synthetic group restructuring

US bankruptcy courts will adjudicate the Chapter 11 case of a foreign-domiciled entity when it is an affiliate of a US entity, so long as it has a minimal quantity of property in the US. The courts have defined the "property" requirement broadly and hold that only a minimal amount of property in the US is needed to qualify as a debtor.[60] It is not uncommon, therefore, for multinational corporate groups to open Chapter 11 cases not only for the group's US affiliates, but for the group's non-US affiliates as well.

If a foreign-domiciled entity's bankruptcy case is being administered by a US bankruptcy court under Chapter 11, there is no statutory or common law authority that would permit a US court to apply the law of a foreign jurisdiction to that case so as to

USC § 1509(b)(3) (where a court grants recognition of a foreign proceeding, it "shall grant comity or cooperation to the foreign representative").

[56] See 11 USC § 1507(a).

[57] 11 USC §1507(b).

[58] 11 U.S.C. §§ 1507(b) (providing that when granting "additional relief," the court should consider, among other things, whether the relief will reasonably assure distribution of the debtor's property "substantially in accordance with the order prescribed by [the Bankruptcy Code]"); 1521 (specifying various forms of relief that may be granted upon recognition of a foreign proceeding, but only "where necessary to effect the purpose of [the Bankruptcy Code]" and subject to various restrictions set forth in subsections (b)-(f))

[59] *In re Metcalfe & Mansfield*, 421 BR at 696–898 (granting requested enforcement of a Canadian reorganisation plan that included third-party non-debtor releases, notwithstanding that such releases would likely not be authorised under US law, where the releases treated all claimants in the Canadian proceeding similarly, the Canadian procedures were "consistent with standards of US due process" and thus satisfied "our fundamental standards of fairness", and there was no challenge to enforcement in the US); *In re Sino-Forest Corp*, 501 BR 655, 665 (Bankr SDNY 2013) (enforcing a non-debtor release and injunction issued by a Canadian bankruptcy court, following the court's reasoning in *Metcalfe*); see also *In re Rede Energia SA*, 515 BR 69, 100 (Bankr SDNY 2014) (noting that the creditors opposed to the enforcement of a Brazilian reorganisation plan that substantively consolidated a corporate group had exercised their due process rights in Brazil to both object to the plan and appeal the decision approving the plan, and holding that the plan should be enforced in the US pursuant to §§1521 and 1507 of the US Bankruptcy Code, even where the Brazilian legal standard for substantive consolidation diverged from the US standard).

[60] See *In re McTague*, 198 BR 428, 431-32 (Bankr WDNY 1996) (a US bank account containing $194 was sufficient "property" to make the account holder eligible to be a debtor under §109(a)).

replicate the results that would be achieved in a proceeding in that jurisdiction. Thus, a synthetic consolidated group restructuring is unavailable in the US. However, a foreign-domiciled debtor that has opened a case under Chapter 11 may still seek the appointment of a foreign representative under section 1505 of the US Bankruptcy Code to initiate an outbound ancillary proceeding.

3. Duty to initiate insolvency process

As noted above, there is no obligation for directors of a US legal entity to open a bankruptcy case for that entity because a parent or affiliate within the same corporate group has become insolvent or opened their own insolvency proceedings outside the US.[61] Further, there is no requirement that a US entity or corporate group must be restructured under the laws of the US.

Thus, there is no law in the US that would expressly prevent US courts from recognising a synthetic group restructuring in a foreign jurisdiction. In fact, in at least one instance, a US bankruptcy court has granted Chapter 15 recognition of a foreign main proceeding involving a corporate group that included one US incorporated debtor.[62]

However, the fact that US law does not prohibit US entities from being reorganised together with their corporate group in another jurisdiction does not ensure the results of the group's foreign proceedings will be recognised and enforced in the US. The US Bankruptcy Code affords US creditors several protections in these circumstances. For example, if US-based creditors believe they would do better in a US-based restructuring than they would in a foreign restructuring, they may seek to place the US entities within a corporate group (alone or together with some or all of the foreign entities in the group) into involuntary bankruptcy cases under Chapter 7 or Chapter 11 of the US Bankruptcy Code.[63] To the same end, at the urging of US creditors or of its own volition, a foreign-based corporate group with US affiliates may open Chapter 11 cases in the US in an attempt to avoid some aspect of foreign insolvency law perceived to be detrimental relative to the protection and relief available under the US bankruptcy code. In either scenario, the likely result is that either US and non-US proceedings open and progress in parallel,[64] or a struggle for main proceeding status ensues.

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[61] Nor is it mandatory for a US entity to be placed into bankruptcy if it is rendered insolvent or likely insolvent as a result of the financial condition or opening of insolvency proceedings for its parent or affiliates. Oftentimes, however, bankruptcy may be the best (if not only) means to protect and preserve the US entity's assets and business operations in those instances. Fiduciaries of a US entity whose foreign parent or corporate group affiliates have been placed into insolvency proceedings should consider whether opening a US bankruptcy case is in the best interests of the entity's stakeholders.

[62] See Order Recognising Foreign Main Proceeding and Granting Additional Relief, *In re Karhoo Inc*, No 16-13545 (Bankr SDNY 1 February 2017) [Docket No 31] (recognising UK administrations of Delaware parent corporation and several UK subsidiaries as foreign main proceedings).

[63] A bankruptcy case may be initiated involuntarily (i.e. without support of the debtor entity in question) by three or more creditors holding unsecured claims of at least US $18,600 in the aggregate that are not contingent as to liability or subject to *bona fide* dispute as to either liability or amount: 11 USC § 303(b)). Unlike when a debtor files a voluntary petition, which causes a bankruptcy case to be opened automatically, a bankruptcy case commenced by creditors will not be opened until their involuntary petition is granted by the US bankruptcy court upon a determination that either: (1) the debtor is not generally paying its debts as they become due; or (2) a trustee or receiver was appointed over some portion of the debtor's property within 120 days before the petition. 11 USC § 303(h).

[64] In a recent example, creditors successfully initiated an involuntary Chapter 7 case in New York during the 60-day interim period between the commencement of a provisional liquidation proceeding for

In cases of struggle, the presiding US bankruptcy court is typically urged by foreign creditors and / or insolvency practitioners (IPs) to dismiss or abstain from adjudicating the Chapter 11 case so that the foreign insolvency proceedings can be initiated and continue unabated.[65]

This struggle recently played out in the *Exelco* case, where a corporate debtor group predominantly centred in Belgium, but with two US subsidiaries, filed for Chapter 11 in Delaware in an attempt to block liquidation proceedings against the group that had been brought by two creditors in Belgium.[66] At the outset of the Chapter 11 cases, the Delaware bankruptcy court issued orders intended to halt the Belgian proceedings by restraining the two Belgian creditors. Nevertheless, the Belgian court moved forward by ordering the appointment of Belgian liquidators and directing them to seek Chapter 15 recognition of the Belgian liquidation from the Delaware bankruptcy court. Although the Delaware court found it had the authority to reorganise the entire corporate group (in part because of the group's Delaware affiliates), the court granted the Belgian creditors' motion to dismiss the Chapter 11 cases in deference to the Belgian liquidation and granted the Belgian liquidators' petition for Chapter 15 recognition of the liquidation as a "foreign main proceeding".[67] In reaching this conclusion, the Delaware court applied a seven-factor abstention test that includes consideration of whether the non-US forum protects the interest of creditors and the economical and efficient administration of the debtors' affairs, among other factors.[68]

In explaining its decision, the Delaware court noted that, prior to commencing Chapter 11, the corporate group had voluntarily opened (then subsequently dismissed) its own Belgian proceeding and, therefore, could not credibly claim any prejudice or unfairness in being subjected to further Belgian proceedings at the hands of its Belgian creditors.[69] The Delaware court also interpreted the actions by the Belgian court as a clear indication that it would not enforce the effects of a Chapter 11

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the same debtor before the Grand Court of the Cayman Islands and the conversion of those proceedings to a court-supervised official Cayman liquidation: *Lamonica v CEVA Group plc (in re CIL Ltd)*, 582 BR 46, 66 (Bankr SDNY 2018). Following his appointment in the US bankruptcy case, the Chapter 7 trustee entered into an international protocol with the joint official liquidators in the Cayman proceeding by which the IPs agreed to allow certain avoidance actions and other recovery claims to be pursued in the Chapter 7 case, ostensibly because they agreed US law offered greater chances for successful recovery on such claims than Cayman law: ibid. Notwithstanding the protocol agreement, however, the US bankruptcy court subsequently dismissed certain of those claims brought by the Chapter 7 trustee under US law, holding that a choice of law analysis indicated the claims should be brought (if at all) under Cayman law: see *idem*, 99–103.

[65] For example, in *In re Northshore Mainland Services, Inc*, 537 BR 192 (Bankr D Del 2015), a corporate group of 14 Bahamian entities with one Delaware affiliate in the midst of constructing a hotel and casino resort property in the Bahamas voluntarily filed Chapter 11 cases in Delaware, hoping to use the cases to keep their secured lender at bay while obtaining additional financing to complete construction. The secured lender, which was affiliated with the project's general contractor, whom the debtors blamed for construction being significantly delayed and over-budget, moved to dismiss the cases in favour of insolvency proceedings in the Bahamas. The debtors objected to dismissal, including on the basis that Bahamian insolvency law lacked a restructuring regime and therefore dismissal of the Chapter 11 cases would lead directly to liquidation proceedings in the Bahamas for the benefit of the secured lender. Ultimately, the Delaware bankruptcy court dismissed the Chapter 11 cases of the 14 Bahamian entities, after which ownership and control of the project was promptly wrested from the debtors' equity sponsor through Bahamian liquidation and receivership proceedings.

[66] See *In Re Elexco NV*, 17-BK-12030 (Bankr D Del 13 December 2017).

[67] *Idem* [Docket Nos 84, 98-2].

[68] *Idem* [Docket No. 98-2], 227.

[69] *Idem* [Docket No. 98-2], 222.

restructuring in Belgium where the corporate group's assets and business were almost exclusively located.[70]

In summary, assuming that a corporate group had opened a main proceeding in a foreign jurisdiction, and that the creditors of the group's US affiliates would be no worse off (and no better off) in the absence of a bankruptcy filing for the US affiliates, there would be a sufficient legal basis not to open US bankruptcy proceedings. Of course, each situation is different, and directors of US-based entities should seek advice from appropriate professionals, particularly where opening US proceedings could potentially result in a better outcome for the US entities' creditors. Ultimately, as long as the directors have fulfilled their duties of care and loyalty in good faith, under the "business judgment rule", US courts will presume that the directors' decision regarding whether to open US bankruptcy proceedings was valid and proper, so long as a rational business purpose for the decision has been articulated.

4. Legal certainty and predictability

4.1 Legal certainty and predictability to local creditors

In the event of a corporate group's restructuring in a non-US jurisdiction, the best means to ensure legal certainty and predictability in the US would be to file Chapter 15 proceedings, if available. Such a filing would protect the corporate group and its foreign creditors from actions that could be taken by local US creditors, such as execution against US assets or the commencement of litigation aimed at disrupting the foreign restructuring efforts.[71]

4.2 Communications with local courts and creditors

To satisfy due process concerns, US debtors must provide proper notice of the bankruptcy to both known and unknown creditors. If a creditor is known, the debtor must provide actual notice of the bankruptcy proceedings. For unknown creditors, the debtor can provide constructive notice by publishing information about the bankruptcy, typically through notices in newspapers. When notice is provided by publication, the court determines the form and manner of such publication, including which newspapers or other medium to be used and the number of publications.[72] To satisfy due process concerns, the debtor must use methods of publication notice that are reasonably calculated to inform unknown creditors. Debtors can generally satisfy this requirement by publishing in a national newspaper and local newspapers in the regions where the debtor conducts business.[73]

4.3 Guarantees by the IP in office

There is no requirement under US law for an IP to provide any guarantees during the administration of a bankruptcy case. Nevertheless, to the extent an IP seeks Chapter 15 recognition of a non-US proceeding to restructure the assets or affairs of a corporate group with assets or affairs in the US, US creditors concerned about their treatment in the non-US proceeding do have a number of other protections under the US Bankruptcy Code. For example, in a Chapter 15 case, US bankruptcy courts will not turn over assets located in the US to the foreign representative for repatriation and

[70] *Idem* [Docket No. 98-2], 225–226.
[71] 11 USC §§ 1519(a), 1520(a), 1521(a).
[72] See Fed R Bankr P 9008.
[73] *Chemetron Corp v Jones*, 72 F3d 341, 349 (3d Cir 1995).

distribution in the foreign proceeding unless US creditors will be "sufficiently protected".[74] Moreover, US creditors also have the right to commence an involuntary case against US entities in the corporate group under Chapters 7 or 11, although if a Chapter 15 case was previously opened the presiding US bankruptcy court does have the discretion to stay that right under appropriate circumstances.[75]

5. Consolidation of assets

5.1 Procedure with respect to the sale of the whole or part of a business

In a bankruptcy case filed under Chapter 11 of the US Bankruptcy Code, a debtor in possession (or a trustee if the debtor is no longer in possession) may sell all or any portion of its assets (including business units as going concerns) outside of the ordinary course of business in two ways: (i) pursuant to section 363 of the Bankruptcy Code (a 363 sale); or (ii) pursuant to a Chapter 11 plan of reorganisation (a plan sale).

5.1.1 363 sales

Typically, 363 sales are accomplished via the filing of a motion with the bankruptcy court on 21 days' notice. Creditors are not entitled to vote on a 363 sale, assuming such a sale is effectuated outside the contours of a Chapter 11 plan of reorganisation. Although creditors and certain parties-in-interest may object to a 363 sale and present their arguments against such sale at a hearing, a court is generally obligated to overrule these objections if the debtor establishes: (i) a business justification for the sale; (ii) that the purchase price is fair and reasonable; (iii) that proper notice of the sale has been provided; and (iv) that the purchaser is proceeding in good faith.[76] The standard for court approval does not change if the assets being sold are jointly owned by multiple debtors or if the assets of multiple debtors are being sold together.

Courts tend to scrutinise the business justification for a 363 sale more closely when the sale: (i) involves all or substantially all of the debtor's assets; and (ii) is accomplished outside of a Chapter 11 plan of reorganisation and, therefore, avoids the voting requirements attendant to confirmation of a Chapter 11 plan (discussed below).[77] Nevertheless, 363 sales of all or substantially all of a corporate group's assets prior to confirmation of a Chapter 11 plan are routinely approved by US bankruptcy courts.

5.1.2 Plan sales

A plan sale is effectuated pursuant to a debtor's Chapter 11 plan of reorganisation.

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[74] 11 USC § 1522. See e.g. *In re International Banking Corp BSC*, 439 BR 614, 627–629 (Bankr SDNY 2010) (denying, without prejudice, the motion of foreign representative seeking turnover of funds in a US account subject to attachments obtained by US creditors on the basis that the foreign representative failed to establish that US creditors' interests would be sufficiently protected in foreign proceeding).

[75] *In re RHTC Liquidating Co*, 424 B.R. 714, 729 (Bankr WD Pa 2010), certain creditors did exactly that. Specifically, the *RHTC* case involved an involuntary Chapter 7 case filed against a US entity, despite the prior Chapter 15 recognition of a Canadian proceeding that included both the US entity and its Canadian parent. The foreign representative in the Chapter 15 case challenged the involuntary Chapter 7 filing, but the US court overruled this challenge in light of: (i) misgivings as to the fairness of the Canadian proceeding *vis-à-vis* the creditors of the US entity; (ii) the existence of post-petition transfers made from the US entity to the Canadian entity; and (iii) the fact that the funds to be distributed in the Canadian proceeding derived mostly from the sale of US assets.

[76] See *In re Gen Motors Corp*, 407 B.R. 463, 493–494 (Bankr SDNY 2009), *aff'd in part*, *In re Motors Liquidation Co,* 829 F3d 135 (2d Cir 2016).

[77] *Ibid.*

Under section 1129 of the US Bankruptcy Code, a plan can be confirmed consensually or non-consensually. To be consensual, section 1129(a) requires that every class of claims impaired by the plan – i.e. claims that will not be paid full as and when they would have become due had the bankruptcy not intervened – must vote to accept the plan.

Under the voting requirements of section 1126(c), a class of claims is deemed to accept the plan when it is approved by a vote of creditors holding at least 51% in number and constituting at least 66% of the dollar amount of the claims in that class. When one or more class of creditors vote to reject the plan, it can still be confirmed non-consensually (i.e. through a cram down), provided the plan: (i) is accepted by at least one impaired class; (ii) does not unfairly discriminate against any class of creditors; and (iii) is fair and equitable.[78]

363 sales may also be pursued in Chapter 7 liquidation cases. Indeed, 363 sales are consistent with one of the Chapter 7 trustee's primary duties, which is "to collect and reduce to money the property of the estate … and close such estate as expeditiously as is compatible with the best interests of parties in interest".[79] Generally, the standard for approval of a 363 sale in Chapter 7 is the same standard applicable in Chapter 11.[80] A Chapter 7 trustee may not pursue a plan sale, as plans of reorganisation are not available in Chapter 7.

5.2 Difference in treatment with respect to tangible and intangible assets

Generally, the US law discussed herein concerning the consolidation of legal entities and the disposition of consolidated assets does not change depending on the type of assets that are consolidated or sold, assuming the applicable debtors are not regulated entities (e.g. broker-dealers).

5.3 Role of creditors and creditors' committees in a substantive consolidation

A court can order the substantive consolidation of debtors' estates prior to confirmation of a Chapter 11 plan and, therefore, without a vote of creditors. Such relief, however, is rarely ordered. It is more common for a court to order substantive consolidation in connection with a Chapter 11 plan of reorganisation. As noted, under the cram down provision in section 1129(a)(10) of the US Bankruptcy Code, a plan of reorganisation, including a plan involving substantive consolidation, can be confirmed over the objection of an impaired class of creditors provided that, among other things, at least one impaired accepting class has voted in favour of the plan. Security holders and priority creditors and ordinary creditors are typically placed into different voting classes under a Chapter 11 plan because of their different rights, so that security holders can demand to receive the value of their collateral and priority creditors can demand to have their priority claims paid in full before any payment is made on account of non-priority claims. But none of these creditors are given greater voting rights than ordinary creditors, *per se*. For example, security holders whose collateral is insufficient to cover the full amount of their claims often have their unsecured deficiency claims classified together with other non-priority unsecured creditors. In any event, regardless of the type of creditor or claim involved, any impaired class of claims that votes to accept a plan by requisite majorities of its non-

[78] 11 USC § 1129(b).
[79] 11 USC § 704(a)(1).
[80] See *In re Childers*, 526 BR 608, 613 (Bankr DSC 2015); *In re Shipman*, 344 BR 493, 495 (Bankr ND W Va 2006); *In re Bakalis*, 220 BR 525, 532 (Bankr EDNY 1998).

insider creditors can be used as the basis to cram down the plan on other dissenting classes.

Although the relatively few US courts to address the issue have reached opposite conclusions, the apparent majority view is that US bankruptcy courts agree that "it is appropriate to test compliance with section 1129(a)(10) on a per-plan basis, not … on a per-debtor basis".[81] This means that, for a cram down plan involving multiple debtors, the plan proponents would need to show only that a single impaired class of creditors under the consolidated plan voted in favour of the plan and not that an impaired class of creditors of each debtor voted in favour of the plan.[82] As a result, it is possible that a plan providing for substantive consolidation could be confirmed, even where all the creditors of one the legal entities to be consolidated voted unanimously against the consolidation.

In most large corporate group Chapter 11 cases, a single official committee of unsecured creditors represents the interests of all unsecured creditors throughout the debtor group. In those cases in which the interests of creditors of one debtor or group of debtors within the overall corporate group substantially conflict with the interests of creditors of another debtor or debtor group, multiple official committees will sometimes (but not always) be appointed. When they are not, *ad hoc* creditor groups often form to voice the positions of creditors on each side of the conflict.

5.4 Voting for or against a substantive consolidation

Creditors are not entitled to vote on substantive consolidation unless it is part of a Chapter 11 plan, as set forth above. A class of creditors that would do better in a proposed Chapter 11 plan than they would in a liquidation is generally entitled to vote on the plan, even if such creditors would have received nothing in a liquidation.[83] However, a vote against the plan by such a class of creditors would not prevent the plan from being confirmed, so long as the cram down requirements are met, along with the other requirements for confirmation of a Chapter 11 plan. One such requirement is the "best interests of creditors" test, which, as a general matter, mandates that, with respect to each impaired class of creditors, each holder of a claim: (i) has accepted the plan; or (ii) will receive or retain under the plan property of a value that is not less than the amount such holder would receive if the debtor were liquidated under Chapter 7 of the US Bankruptcy Code.[84]

6. Equitable distribution and accountability of IPs

Regardless of the result of a US bankruptcy case, an IP cannot be held liable absent the commission of a tort, such as professional malpractice. Further, the purpose of Chapter 11 of the US Bankruptcy Code is reorganisation, and many successful

[81] *In re Charter Commc'ns*, 419 BR 221, 266 (Bankr SDNY 2009) (citing numerous examples of joint Chapter 11 plans that were confirmed without each debtor having an impaired accepting class). The only Court of Appeals decision to address the issue agreed with this view: see *Matter of Transwest Resort Properties, Inc.*, 881 F.3d 724, 729–30 (9th Cir. 2018); but note in contrast *In re Tribune Co*, 464 BR 126, 183 (Bankr D Del 2011) (refusing to follow *Charter Commc'ns* and holding that the impaired accepting class requirement for Chapter 11 confirmation applied on a debtor-by-debtor basis even where a single plan provided for the reorganisation of multiple corporate group debtors).

[82] *See In re Woodbridge Group of Companies, LLC*, 592 B.R. 761, 778 (Bankr. D. Del. 2018) (This Plan provides for substantive consolidation; therefore, acceptance by one impaired class satisfied § 1129(a)(10)).

[83] Creditors are deemed to reject a Chapter 11 plan if the plan does not provide them with a recovery.

[84] 11 USC § 1129(a)(7)(A).

Chapter 11 reorganisations are accomplished via cram down, a debt-for-equity exchange or a combination of both. Many stakeholders in distressed US companies (and their IPs) prefer the speed and relatively small expense of a "pre-packaged" Chapter 11 case in which a debtor files for bankruptcy with a fully negotiated plan of reorganisation and with corresponding lockup agreements from major creditor groups that ensure the plan's approval. Although pre-packaged plans generally leave ordinary unsecured creditors unimpaired, they often involve a debt-for-equity or other exchange of senior indebtedness.

7. Intercompany claims

7.1 Order of priority

Valid intercompany claims are entitled to the same treatment as third-party claims in terms of priority and the amount of distribution they should receive. Intercompany claimants are, however, treated differently for the purpose of voting on a plan of reorganisation. For a cram down plan to be confirmed, it must be approved, without counting votes cast by insiders, by at least one class of "impaired" claims – that is, claimants whose rights are altered by the terms of the plan.[85] Thus, a plan cannot be confirmed based solely on the approval of corporate insiders.

7.2 Concepts that can alter priority

Recharacterisation and equitable subordination are both available as remedies in US bankruptcy cases with respect to all debt, including intercompany claims.

Recharacterisation is not expressly provided for in the US Bankruptcy Code. Nevertheless, US bankruptcy courts may invoke this equitable remedy to "recharacterise" a purported debt claim as an equity ownership interest in the debtor.[86] If recharacterisation is granted, the claims asserted by the purported debt holder will be treated instead as equity interests for all purposes under the US Bankruptcy Code, including for the purpose of distribution. In deciding whether recharacterisation is appropriate, US courts consider a number of factors to determine whether the parties intended for the investment to be: (i) a financing; or (ii) an equity investment disguised as a financing. Intent "may be inferred from what the parties say in their contracts, from what they do through their actions, and from the economic reality of the surrounding circumstances".[87]

Section 510(c) of the US Bankruptcy Code provides for the remedy of equitable subordination, although its contours are supplied by case law. A court can use equitable subordination to reorder the payment priority of an otherwise legitimate claim if fairness demands that such a claim falls behind those of other claimants.[88] When determining whether all or part of a claim should be equitably subordinated, US courts typically require a showing that the creditor holding such a claim engaged in inequitable conduct – such as lack of good faith by a fiduciary, fraud or unjust enrichment – and that such conduct either injured other creditors or provided the

[85] 11 USC §§ 1124, 1129(a)(10).
[86] *In re SubMicron Sys Corp*, 432 F3d 448, 456 (3d Cir 2006) ("[T]he focus of the recharacterisation inquiry is whether 'a debt actually exists', or, put another way … what is the proper characterisation in the first instance of an investment").
[87] *Idem*, 454. See also *In re AutoStyle Plastics, Inc*, 269 F3d 726, 749 (6th Cir 2001).
[88] *SubMicron*, 432 F3d, 454.

offending creditor with an unfair advantage.[89] Most cases of equitable subordination are brought against creditors who are corporate insiders, and, in such cases, the party seeking equitable subordination must present "material evidence" of the insider-creditor's inequitable conduct to shift the burden to the claimant, which then must demonstrate that its conduct was fair.[90] In cases brought against non-insider creditors, courts impose a higher burden of proof as to the alleged misconduct which is rarely satisfied, and thus equitable subordination against true third-party creditors is rarely granted.[91]

8. Administering a complex estate in one single consolidated procedure

More than one group can exist within an enterprise group for insolvency purposes and the US bankruptcy regime is capable of handling multi-corporate group cases. US bankruptcy judges, especially those in key US districts such as Delaware, the Southern District of New York and the Southern District of Texas, are accustomed to managing reorganisations of large and complex companies with numerous operating subsidiary groups.

Further, the complexity of a corporate group does not serve as a barrier or limitation to the application of the modified universalism rules codified by Chapter 15 of the US Bankruptcy Code.

9. Handling an insolvent parent with a healthy subsidiary

Regarding procedural consolidation, it is possible under US bankruptcy law for a solvent subsidiary to open its own bankruptcy case and have it jointly administered with the cases of its insolvent affiliates within the same enterprise group. There is no insolvency prerequisite for any corporate group member to open a US bankruptcy case.[92] Moreover, because Chapter 11 debtors remain in possession of their assets (unless and until a trustee is appointed for cause), an insolvent member of the corporate group will continue to exercise the same shareholder rights it had outside of Chapter 11 with respect to any of its wholly owned solvent subsidiaries, including influence or control over the decision whether those subsidiaries will enter bankruptcy as well.

For example, in the Chapter 11 cases of General Growth Properties Inc (GGP) and its affiliates, GGP caused 166 solvent subsidiaries to file for Chapter 11.[93] In these circumstances, creditors may move to dismiss the Chapter 11 case of a solvent debtor on the ground that it was opened in bad faith. The success of any such motion will be highly dependent on the facts of the case. Indeed, some courts, including the

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[89] See e.g. *Benjamin v Diamond* (*In re Mobile Steel Co*), 563 F2d 692, 700 (5th Cir 1977); *In re Verestar, Inc*, 343 BR 444, 460–461 (Bankr SDNY 2006).

[90] *US v State St Bank & Trust Co*, 520 BR 29, 80 (Bankr D Del 2014).

[91] *In re Granite Partners, LP*, 210 BR 508, 515 (Bankr SDNY 1997) ("Where non-insider, non-fiduciary claims are involved, the level of pleading and proof is even higher. Although courts now agree that equitable subordination can apply to an ordinary creditor, the circumstances are few and far between") (citations and internal quotation marks omitted).

[92] 11 USC 109; *In re Marshall*, 300 BR 507, 510 (Bankr CD Cal 2003) ("As a statutory matter, it is clear that the bankruptcy law does not require that a bankruptcy debtor be insolvent, either in the balance sheet sense (more liabilities than assets) or in the liquidity sense (unable to pay the debtor's debts as they come due), to file a Chapter 11 case or proceed to the confirmation of a plan of reorganisation").

[93] Each subsidiary was a special purpose entity that owned a separate shopping mall. *In re Gen Growth Properties, Inc*, 409 B.R. 43, 55 (Bankr SDNY 2009) (refusing to dismiss the solvent subsidiaries' bankruptcy cases on the grounds that they were filed in bad faith).

presiding court in GGP's bankruptcy, have held that a case should not be dismissed unless the party challenging the bankruptcy petition establishes, as a factual matter, both subjective bad faith in the filing of the petition and objective futility in the reorganisation process.[94]

Substantive consolidation of a solvent subsidiary into the bankruptcy estate of an insolvent enterprise group is a separate issue. Such consolidation, although theoretically possible, is exceedingly unlikely to be ordered. As discussed previously, one of the more recent and popular tests permits substantive consolidation only upon proof that: (i) prior to bankruptcy creditors extended credit in reliance on the corporate group as a whole, rather than on the separate assets and liabilities of individual members of the group; or (ii) the books, records and financial affairs of members of the corporate group are so commingled that untangling them during the bankruptcy would be costly and leave all creditors worse off.[95] By definition, creditors of a solvent debtor within a corporate group will be worse off if its assets and liabilities are combined with those of its insolvent group affiliates except in the rare circumstance the combined assets of the group are sufficient to satisfy all group liabilities. Therefore, the likely focus of a challenged request for substantive consolidation will be whether creditors of a solvent group entity relied upon that entity's separateness from the group as a whole.

Most sophisticated corporate group lenders will take steps before extending financing that demonstrate their reliance on the separateness of each obligor (i.e. the borrower and each guarantor). For example, covenants within contemporary US corporate financing agreements typically restrict the transfer of assets: (i) outside of the obligor group above a capped aggregate value; and (ii) between entities within the obligor group unless appropriate formalities respecting corporate separateness are maintained.

Nevertheless, lenders may be exposed to an attempt to substantively consolidate the obligor group in bankruptcy if they fail to negotiate these contractual protections or conduct appropriate diligence in advance of lending. The much more likely scenario in which creditor reliance may be in dispute is when separateness within the corporate group is hidden or obscured by a borrower perpetuating a Ponzi scheme or other fraud. In that scenario, a request for substantive consolidation of solvent and insolvent corporate group members may gain traction, especially if corporate separateness was equally hidden from creditors of insolvent group members.

[94] *Ibid* (citing *In re Kingston Square Assocs,* 214 BR 713, 725 (Bankr SDNY1997)).
[95] *In re Owens Corning*, 419 F3d 195, 211 (3d Cir 2005).

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