United Nations A/CN.9/WG.V/WP.78

General Assembly

Distr.: Limited
26 August 2007

Original: English

United Nations Commission on International Trade Law
Working Group V (Insolvency Law)
Thirty-third session
Vienna, 5-9 November 2007

Treatment of enterprise groups in insolvency

Note by the Secretariat

I. Introduction

1. This note draws upon the material contained in documents A/CN.9/WG.V/WP.74 and Add.1 and 2, A/CN.9/WG.V/WP.76 and Add.1 and 2, the UNCITRAL Legislative Guide on Insolvency Law (the Legislative Guide), the UNCITRAL Model Law on Cross-Border Insolvency (the Model Law), and the Reports of Working Group V (Insolvency Law) on the work of its thirty-first and thirty-second sessions (A/CN.9/618 and A/CN.9/622 respectively).

2. At its thirty-second session,[1] the Working Group agreed that a decision on the form of its work was not possible at that stage. However, it also agreed that the approach adopted in working papers prepared for the thirty-first and thirty-second sessions should continue to be adopted. Accordingly, this note includes three sections on each issue – general remarks, recommendations and notes on recommendations.

[1] Report of Working Group V (Insolvency Law) on the work of its thirty-second session, A/CN.9/622, paras. 93-94.

V.07-86330 (E)

II. Glossary

A. General Remarks

(Reference to previous UNCITRAL documents: A/CN.9/WG.V/WP.74, para. 1(a)-(o); A/CN.9/618, paras. 48-49; A/CN.9/WG.V/WP.76, para. 1; A/CN.9/622, paras. 12, 77-84)

1. In addition to explaining a number of terms that occur in the law and literature relating to enterprise groups, paragraph 1 of A/CN.9/WG.V/WP.74 notes that those terms may have different meanings in different jurisdictions or may be common to one legal tradition and not to others. A number of terms are included in this note to provide orientation to the reader and facilitate a common understanding of the issues, but not to provide legal definitions.

B. Terms

2. The Working Group has discussed some of the terms included below; several new terms have been added to provide further explanation. Other terms included in A/CN.9/WG.V/WP.74, but not repeated here, may also be relevant to the issues discussed in this note.

(a) "Domestic [commercial] [business] enterprise group": two or more enterprises, which may include enterprises that are not incorporated, that are bound together by means of capital or control.

(b) "Enterprise": any entity, regardless of its legal form, engaged in economic activities,[2] including entities engaged on an individual or family basis, partnerships or associations.[3]

(c) "Capital": investment in an enterprise as assets, share capital or debt.

(d) "Control": the power normally associated with the holding of a strategic position within the enterprise group that enables its possessor to dominate directly or indirectly those organs entrusted with decision-making authority; slight control or influence is not sufficient. Control could also exist pursuant to a contractual arrangement that provides for the requisite degree of domination.

(e) "Member of an enterprise group": an enterprise that is bound to other enterprises in the manner indicated in the term "enterprise group" and which for the purposes of this work is eligible for insolvency under the insolvency law.[4]

(f) "Procedural coordination": coordinated administration of insolvency proceedings commenced against separate enterprises that are members of the same enterprise group in order to promote procedural convenience and cost efficiency. The assets and liabilities of each member remain separate and distinct, thus

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[2] For an explanation of "economic activities" see Legislative Guide, part two, chap. I, footnote 1.

[3] Based upon the European Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises (2003/361/EC).

[4] Recommendation 8 of the Legislative Guide provides that "The insolvency law should govern insolvency proceedings against all debtors that engage in economic activities, whether natural or legal persons…".

preserving the integrity of the individual enterprises of the enterprise group, and the substantive rights of claimants are unaffected. Procedural coordination may facilitate comprehensive information being obtained on the business operations of the group members subject to the insolvency proceedings; facilitate the valuation of assets and the identification of creditors and others with legally recognized interests; avoid duplication of effort; and […]. Procedural coordination may involve some or all of the following: the appointment of a single insolvency representative to administer the individual insolvency proceedings; combined meetings and hearings; joint deadlines; a single list for the provision of notices; a single creditor committee; and […].

C. Notes on terms

Domestic [commercial] [business] enterprise group

3. Although the deliberations of the Working Group have proceeded on the basis that what is being addressed is the treatment of "corporate groups" in insolvency, the inclusion of unincorporated entities in the scope of the work suggests that a broader term, such as "commercial enterprise group" or "business enterprise group", taking into account the explanation of "enterprise" provided above, might be more appropriate. The Working Group may wish to consider whether one of those terms or some other term might be used in preference to "corporate group".

4. Paragraphs 7-15 and 35-38 of A/CN.9/WG.V/WP.74 identify a number of concepts and features common to groups and their definition in different legislation. The Working Group may wish to consider whether any of those additional concepts, such as coordinated organization and management, commonality of business direction and purpose, use of common trademarks and advertising to promote a single public identity, should be added to the explanation of the term or whether reference to those paragraphs in any commentary to be included in this work would be sufficient.

Capital

5. Use of the term "capital" in the explanation of what constitutes a domestic enterprise group may require further elaboration, as set forth in paragraph 2 (c). The need to explain that term might be avoided, however, if the explanation of what is meant by the term "group" relied only upon a reference to "control", where "control" would be understood to include control based upon ownership.

Control

6. The reference to those groups established by reference to contractual arrangements, previously included in the explanation of "corporate group" (A/CN.9/WG.V/WP.76, para. 3), has been moved to the explanation of "control", in accordance with the suggestion at the thirty-second session of the Working Group[5] that contractual arrangements should only be included in the concept of a group where the contract addresses issues of control of the group.

[5] A/CN.9/622, para. 83.

Enterprise

7. If the explanation of the term "enterprise" is to be included in this work, inclusion of the words "which may include enterprises that are not incorporated" in the explanation of the term "group" may not be required; the explanation of the term "enterprise" makes it clear that entities with different legal forms would be included.

Member of a group

8. The explanation of the term "member of a group" is included to indicate the manner in which it is used in this work, particularly with respect to the coverage of that enterprise by the insolvency law. It may be, however, that with respect to some issues, for example reorganization, the limitation of the scope to enterprises subject to the insolvency law may be too narrow (see below, A/CN.9/WG.V/WP.78/Add.1, para. 41). The Working Group may wish to consider how the term "member of a group" should be used in this work and whether an explanation is required.

Procedural coordination of two or more insolvency proceedings

9. Previously referred to as "joint administration", the term "procedural coordination" has been adopted to avoid any confusion between this type of order and joint application for commencement of insolvency proceedings, as well as to avoid using a term that may have a specific meaning in a limited number of jurisdictions.

Modification of explanations for different substantive provisions

10. The general explanations of terminology above are proposed for the purposes of considering substantive issues of joint application for commencement; procedural coordination; avoidance proceedings; substantive consolidation; a single reorganization plan; and post-commencement financing as discussed in the recommendations set forth below. Where these explanations are inappropriate or insufficiently detailed for application to any particular substantive issue, the Working Group may wish to consider how those general explanations might be modified. It was noted at the thirty-second session[6] of the Working Group that, for example, a broad notion of "group" might be desirable for the purpose of procedural coordination and a narrower concept for avoidance.

Additional terms

11. The Working Group may wish to consider whether terms additional to those set forth in document A/CN.9/WG.V/WP.74 and in paragraph 2 above might be required to facilitate a common understanding of this work.

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[6] A/CN.9/622, para. 81.

III. The onset of insolvency: domestic issues

A. Commencement of insolvency proceedings

1. Joint application for commencement

(References to previous UNCITRAL documents: A/CN.9/WG.V/WP.74/Add.1, para. 12; A/CN.9/618, paras. 15-24; A/CN.9/WG.V/WP.76, paras. 10, 15; A/CN.9/622, paras. 14-20)

(a) General remarks

1. As a general rule, insolvency laws respect the separate legal status of each member of an enterprise group and a separate application for commencement of insolvency proceedings is required to be made for each member satisfying the standard for commencement of insolvency proceedings. There are some limited exceptions that allow a single application to be extended to other members of the group where, for example, all interested parties consent to the inclusion of more than one member of the group; the insolvency of one group member has the potential to affect other members of the group; the parties to the application are closely economically integrated, such as intermingling of assets or a specified degree of control or ownership; or consideration of the group as a single entity has special legal relevance, especially for reorganization plans

2. The recommendations of the Legislative Guide concerning application for and commencement of insolvency proceedings would apply to debtors that are members of an enterprise group in the same manner as they would apply to debtors that are individual commercial enterprises. Recommendations 15 and 16 of the Legislative Guide establish the standards for debtor and creditor applications for commencement of insolvency proceedings and form the basis upon which an application could be made for each member of a group that satisfied those standards, including imminent insolvency in the case of an application by a debtor. In the enterprise group context, the insolvency of a parent enterprise may affect the financial stability of a subsidiary so that its insolvency is imminent. That situation is likely to be covered by the terms of recommendation 15 if, at the time of the application of the parent, it could be said of the subsidiary that it would be unable to pay its debts as they mature.

3. Permitting those members of a group that satisfy the commencement standard to make a joint application for commencement of insolvency proceedings would facilitate the consideration of those applications by the court, without affecting the separate identity of the applicants. Such a joint application might include a single application covering all members of the group that satisfy the commencement standard or parallel applications made at the same time in respect of each of those members. In both cases the insolvency law should facilitate the court undertaking a coordinated consideration of satisfaction of the commencement standards with respect to the individual group members, taking into account the group context.

4. A joint application for commencement by two or more members of an enterprise group may raise issues of jurisdiction, even in the domestic context, if members of the group are located in different places with different courts being competent to consider the respective applications. Some jurisdictions may allow

those applications for commencement to be transferred to a single court where they can be centralized for consideration. Although that approach is desirable, it will ultimately be a question of whether domestic law would allow joint applications involving different courts to be treated in such a way. The fees payable and other associated issues arising out of a joint application for commencement may also need to be addressed.

5. The making of a joint application for commencement of insolvency proceedings should be distinguished from what is referred to below as procedural coordination. The purpose of permitting a joint application is to facilitate coordination of commencement considerations and potentially reduce costs. It does not predetermine how, if the proceedings commence, they will be administered and, in particular, whether they will be subject to procedural coordination. Nevertheless, a joint application for commencement might include an application for procedural coordination, as noted below.

(b) Recommendations

Joint application for commencement of insolvency proceedings

(1) [1][7] The insolvency law [should][may] specify that a joint application for commencement of [insolvency] [reorganization] proceedings may be made (a) by two or more members of an enterprise group where each of those members satisfies the commencement standard in recommendation 15 of the Legislative Guide or (b) by an entity that is a creditor of two or more members of an enterprise group that satisfy the commencement standard in recommendation 16 of the Legislative Guide.

Creditor application: notice to the debtor

(2) [7] The insolvency law should specify that when an application is made by a creditor for commencement of insolvency proceedings against two or more members of an enterprise group, notice of the application is to be given to all members of the group included in the application.

(c) Notes on recommendations

Joint application for commencement of insolvency proceedings

6. At its thirty-second session, the Working Group agreed to retain draft recommendation (1),[8] which addresses the issue of whether a joint application for commencement of insolvency proceedings may be made in respect of two or more members of a group. It does not address the question of whether, if the joint application leads to commencement of proceedings, those proceedings should be administered together; that issue is addressed separately below (see paras. 11-14, recommendations (3)-(8)).

7. The Working Group was also of the view[9] that a recommendation addressing the possibility that a creditor may make an application for commencement covering

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[7] Recommendation numbers in square brackets refer to the numbers those recommendations were given as they appeared in document A/CN.9/WG.V/WP.76 and Add.1.

[8] Report of Working Group V (Insolvency Law) on the work of its thirty-second session, A/CN.9/622, para. 20.

[9] A/CN.9/622, para. 21.

two or more members of a group might be useful and that the secretariat could prepare a draft for future consideration. Accordingly, in addition to the possibility of a joint application being made by two or more members of a group that satisfy the applicable commencement standard in recommendation 15 of the Legislative Guide, draft recommendation (1) also addresses application by an entity that is a creditor of two or more members of the group that satisfy the commencement standard in recommendation 16 of the Legislative Guide.

8. Draft recommendation (1) includes the alternative of "insolvency" or "reorganization" proceedings. The Working Group may wish to recall the suggestion made at its thirty-second session,[10] that there was a need to differentiate between liquidation and reorganization in the case where an application for both types of proceedings were made against members of a group. Accordingly, the Working Group may wish to consider whether a joint application may include both liquidation and reorganization proceedings against different member of the group, in which case the more general formulation "insolvency proceedings" might be appropriate, or whether a joint application may only be made where the proceedings sought to be commenced in respect of each member of the group are the same, whether liquidation or reorganization.

Creditor application: notice to the debtor

9. In accordance with recommendation 19 of the Legislative Guide, notice of an application by a creditor for commencement of insolvency proceedings against two or more members of a group would be provided to those members and notice of commencement of insolvency proceedings against members of a group should be provided in accordance with recommendations 22-25 of the Legislative Guide. Draft recommendation [7] of A/CN.9/WG.V/WP.76, concerning notice to be provided to the debtor where a creditor makes an application for commencement, although approved by the Working Group at its thirty-second session[11] is essentially a restatement of recommendation 19 (a) of the Legislative Guide, providing that notice should be given only to those members of the group included in the application. On that basis, the Working Group may wish to consider whether recommendation (2) should be included in this work.

10. With respect to the provision of notice, the Working Group may also wish to consider whether there are any circumstances in the enterprise group context in which notice might be given to a wider group than contemplated by recommendations 19 and 22 of the Legislative Guide. For example, where another member of the group is solvent but is implicated in the financing arrangements of one or more of the members against which an application has been made or proceedings have commenced, should notice be given also to that other member?

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[10] A/CN.9/622, para. 13.
[11] A/CN.9/622, para. 25.

B. Treatment of assets on commencement of insolvency proceedings

1. Procedural coordination

(References to previous UNCITRAL documents: A/CN.9/WG.V/WP.74/Add.1, para. 12; A/CN.9/618, para. 32; A/CN.9/WG.V/WP.76, paras. 32-37; A/CN.9/622, paras. 25-35)

(a) General remarks

11. Procedural coordination, as noted in the glossary, may refer to varying degrees of integration of insolvency proceedings for the ease and convenience of administration and reduction of costs. Although administered together, the assets and liabilities of each group member involved in the procedural coordination remain separate and distinct, thus preserving the integrity of the individual enterprises of the group and the substantive rights of claimants. Accordingly, the effect of procedural coordination is limited to administrative aspects of the proceedings and does not touch upon substantive issues.

12. Procedural coordination may facilitate streamlining of the proceedings in various ways, through sharing of information to obtain a more comprehensive picture of the situation of the various debtors; combining hearings and meetings; establishing a single list for the provision of notice; setting joint deadlines; and holding joint meetings of creditors. It may also be facilitated by appointment of a single insolvency representative (see below, A/CN.9/WG.V/WP.78/Add.1, paras. 25 and following).

13. Procedural coordination may also raise the issues of jurisdiction noted above with respect to joint applications for commencement (see above, para. 4), where different courts have competence over the various members of the group subject to insolvency proceedings. In jurisdictions where those issues arise, they would generally be determined by reference to domestic procedural law.

14. The benefits to be derived from procedural coordination may be apparent at the time an application for commencement is made or may arise after proceedings have commenced. In either case, it is desirable that the court be given the discretion to consider whether the various proceedings should be procedurally coordinated. The court may consider whether to order procedural coordination on its own initiative, or in response to an application from authorized parties, such as any member of the group subject to insolvency proceedings or a creditor of such member. Whether the order is made at the time of commencement of proceedings or subsequently, it is desirable that notice of that order be given to affected creditors.

(b) Recommendations

Procedural coordination of two or more insolvency proceedings

(3) [8] The insolvency law should specify that the court may decide, at any time, either on its own initiative or on the basis of an application under recommendation (4), that the administration of insolvency proceedings against two or more members of an enterprise group that have commenced in the same or different courts should be coordinated for procedural purposes.

Timing of an application for procedural coordination

(4) The insolvency law should specify that an application for procedural coordination may be made (a) at the time an application for commencement of insolvency proceedings is made under recommendations 15 or 16 of the Legislative Guide; or (b) at any time after the commencement of insolvency proceedings against members of an enterprise group.

Parties permitted to apply for procedural coordination

(5) The insolvency law should specify that an application for procedural coordination may be made (a) by any member of the enterprise group against which insolvency proceedings have commenced; or (b) by a creditor of any of those members of the enterprise group.

Simultaneous hearings

(6) The insolvency law should specify that the court may hold simultaneous hearings to determine the extent to which an order for procedural coordination should be granted.

Notice of procedural coordination

(7) [5] The insolvency law should specify that, when the court orders the procedural coordination of [some or all of] the insolvency proceedings, notice of the order is to be given to all affected creditors of those members of the enterprise group included in the procedural coordination.

Content of notice of procedural coordination

(8) [6] The insolvency law should specify that the notice of an order for procedural coordination is to include, in addition to the information specified in recommendation 25 of the Legislative Guide, information on the conduct of the procedural coordination of relevance to creditors.

(c) Notes on recommendations

Application for procedural coordination of two or more insolvency proceedings

15. Draft recommendation (3) (previously draft recommendation [8] of A.CN.9WG.V/WP.76) has been revised in accordance with the decision of the Working Group at its thirty-second session[12] to take account of the possibility of ordering procedural coordination where the insolvency proceedings are commenced either in the same court or in different courts in the same domestic jurisdiction. As drafted, the recommendation is not intended to alter the domestic provisions relating to judicial competence over insolvency matters. The Working Group may wish to consider, however, whether it would be desirable to recommend that domestic procedural law should facilitate procedural coordination by adopting appropriate provisions.

[12] A/CN.9/622, para. 32.

16. Draft recommendation (3) provides that the court may consider ordering procedural coordination on its own initiative or in response to an application made by parties specified under the insolvency law, as addressed in recommendation (5).

17. In accordance with a suggestion made at its thirty-second session,[13] the Working Group may wish to consider whether the possibility of reversing an order for procedural coordination, returning the estates to separate administration, should be included in the draft recommendations or in notes to those recommendations. The Working Group may also wish to consider the circumstances in which reversing an order for procedural coordination might be appropriate.

Draft recommendations (4)-(6)

18. Draft recommendations (4)-(6) have been added to specify the time at which the application might be made and the parties that might apply for procedural coordination. An application may be made at the same time as an application for commencement against two or more members of the group or against one member of the group when one or more other members of the group are already in insolvency proceedings. An application may also be may be made at any time after commencement of insolvency proceedings against two or more members of the group. To facilitate procedural convenience and cost efficiency, draft recommendation (6) permits the court to hold simultaneous hearings to determine the extent to which the proceedings could be procedurally coordinated. Those hearings may be held in response to an application under recommendation (5) or at the initiative of the court.

Draft recommendation (7)-(8)

19. Draft recommendations (7) and (8) (previously draft recommendations [5] and [6] of A.CN.9WG.V/WP.76) have been revised in accordance with the decision of the Working Group at its thirty-second session.[14] Draft Recommendation (7) is intended to apply irrespective of the time at which the order is made, i.e. at commencement or subsequently. The Working Group may wish to consider whether examples of the additional information of particular relevance to creditors might be included in draft recommendation (8).

2. Protection and preservation of the insolvency estate

20. At its thirty-first session, the Working Group considered application of the stay on commencement of insolvency proceedings, as provided in recommendations 39-51 of the Legislative Guide, in the context of insolvency proceedings commenced against two or more members of a group and concluded that those recommendations would apply equally in that context.

21. The Working Group also considered whether relief should be available to protect and preserve the value of assets of a solvent member of the group, where doing so may be in the interests of group members subject to insolvency proceedings. That issue was raised at the thirty-first session of the Working Group[15]

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[13] A/CN.9/622, para. 28.
[14] A/CN.9/622, paras. 22-24.
[15] A/CN.9/618, para. 31.

and was the subject of draft recommendation [12] of A/CN.9/WG.V/WP.76. Although the Working Group concluded at its thirty-second session[16] that recommendation 12 was not required, it was suggested that in certain limited circumstances, such as to protect an intra-group guarantee, such relief might be available at the discretion of the court and subject to certain conditions.

22. That issue had not been considered in the Legislative Guide, as it did not arise with respect to an individual debtor. However, it may be of particular relevance to enterprise groups because of the interrelatedness of the business of the group. Where financing is arranged on a group basis by way of cross-guarantees or cross-collateralization, the finance provided to one member might affect the liabilities of another, or actions affecting the assets of solvent group members may also affect the assets and liabilities or the ability to continue their ordinary course of business of group members against which applications for commencement have been made or insolvency proceedings have commenced. These situations may thus raise issues of both provisional relief and relief on commencement of proceedings.

23. One example of a situation in which provisional relief might be considered might involve a lender seeking to enforce an agreement against a solvent group member, where that enforcement might affect the liability of a member subject to an application for insolvency proceedings. Similarly, a security interest may be enforced against assets of a solvent entity that are central to the business of the group, including the business of group members subject to an application for insolvency proceedings.

24. Those situations may raise questions as to whether the lender's right to enforce its security interest or guarantee should be stayed, on a provisional basis, to protect the estate of the group members subject to an application for insolvency proceedings. Recommendation 39 of the Legislative Guide addresses provisional measures, specifying the types of relief that might be available "at the request of the debtor, creditors or third parties, where relief is needed to protect and preserve the value of the assets of the debtor or the interests of creditors, between the time an application to commence insolvency proceedings is made and commencement of the proceedings". The Working Group may wish to consider whether recommendation 39 of the Legislative Guide would be sufficient in such circumstances.

3. Post-commencement finance

(References to previous UNCITRAL documents: A/CN.9/WG.V/WP.74/Add.1, para. 19; A/CN.9/618, para. 34; A/CN.9/WG.V/WP.76, paras. 54-57; A/CN.9/622, paras. 39-60)

(a) General remarks

25. Post-commencement finance, acknowledged as being critical for an individual commercial enterprise in insolvency proceedings, may be even more critical in the enterprise group context. In both liquidation, especially where there is the possibility of sale as a going concern, and reorganization, the lack of ongoing funds practically prevents a successful result for an insolvent group being achieved.

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[16] A/CN.9/622, para. 36.

26. In the enterprise group context, the question of post-commencement finance raises a number of issues that are different to those arising in the case of a single enterprise. These would include: the potential for conflict of interest between the needs of the different debtors with respect to ongoing finance, particularly where a single insolvency representative is appointed for several members of the group; involving solvent members of the group in post-commencement finance, especially where the solvent member is controlled by the insolvent parent of the group; using the assets of a solvent special purpose entity with a single creditor for the purposes of obtaining finance for other insolvent members of the group; balancing the interests of individual members of the enterprise group with the reorganization of the group; and the desirability of maintaining, in insolvency proceedings, the financing structure that the group had before the onset of insolvency, especially where that structure involved pledging all of the assets of the group to obtain finance that was channelled through a centralized group entity with treasury functions.

27. The use of group assets to obtain post-commencement finance raises few issues not already addressed by the Legislative Guide where all members of the group are subject to insolvency proceedings. One issue that does need clarification is the conditions that would apply and the approvals required where one member provides finance for the use of another member, whether based on the granting of a security interest, guarantee or other assurance of repayment. Another issue to be clarified concerns those situations where the granting of a guarantee by one member subject to insolvency proceedings to another such member might constitute a preferential transaction.

28. Difficulties arise, however, where the assets of a solvent member of the group are used to fund a member subject to insolvency proceedings. A solvent group member might have an interest in the financial stability of the parent, other members of the group or the group as a whole in order to ensure its own financial stability and the continuation of its business. However, use of the assets of a solvent member of a group as a basis for obtaining finance for an insolvent member from an external source or for funding the insolvent member directly may raise a number of questions, especially where that solvent member subsequently becomes insolvent.

29. Issues may include whether the solvent subsidiary would be entitled to priority under recommendation 64 of the Legislative Guide; whether such a transaction might be subject to subordination as intra-group lending; or whether such a transaction might be considered a preferential transaction in any subsequent insolvency of the member providing that finance. Under some laws, providing such finance may constitute a transfer of the assets of that solvent entity to the insolvent entity to the detriment of the creditors and shareholders of the solvent entity. In the context of procedural coordination, the appointment of a single insolvency representative might raise conflicts of interest (see below, A/CN.9/WG.V/WP.78/Add.1, paras. 27-28).

30. While the consequences of the provision of finance by a solvent member may be regulated by the insolvency law, the solvent entity would provide that finance on its own authority under company law in a commercial context and not under the insolvency law. Different types of solvent entities, such as special purpose entities with few liabilities and valuable assets, could be involved in granting a guarantee or security interest.

(b) Recommendations

Attracting and authorizing post-commencement finance

(9) [14] The insolvency law should facilitate and provide incentives for post-commencement finance to be obtained, in the context of insolvency proceedings commenced against two of more members of an enterprise group, for the reasons and on the basis set forth in recommendation 63 of the Legislative Guide.

(10) [13] The insolvency law should specify that, in accordance with recommendations 64-68 of the Legislative Guide, any member of an enterprise group that is subject to insolvency proceedings can obtain post-commencement financing under the circumstances and standards set forth in recommendations xx-xx, below.

Priority for post-commencement finance

(11) [16] Recommendation 64 of the Legislative Guide should apply to the priority that may be accorded to post-commencement finance provided to a member of an enterprise group in the same way that it applies to post-commencement finance provided in the context of a debtor that is not a member of a group.

Security for post-commencement finance

(12) [17] The insolvency law should specify that a security interest of the type referred to in recommendation 65 of the Legislative Guide may be granted by one member of an enterprise group for repayment of post-commencement finance provided to another member of that group [in accordance with the requirements of the insolvency law][provided]:

[(a) The insolvency representative of the guarantor consents to the provision of that security interest; or

(b) The court with jurisdiction over the guarantor determines that the creditors of the guarantor will not be adversely affected by the security interest.]

Guarantee or other assurance for repayment of post-commencement finance

(13) [15] The insolvency law should specify that a member of an enterprise group that is subject to insolvency proceedings may guarantee or provide other assurance of repayment for post commencement finance obtained by another member of the group subject to insolvency proceedings, provided:

(a) The insolvency representative of the guarantor consents to the provision of that guarantee or other assurance of repayment; or

(b) The court with jurisdiction over the guarantor determines that the creditors of the guarantor will not be adversely affected by the guarantee or other assurance of repayment.

(c) Notes on recommendations

Attracting and authorizing post-commencement finance

31. The Working Group approved the substance of draft recommendation (9) (previously draft recommendation [14] of A/CN.9/WG.V/WP.76) at its thirty-second session,[17] based as it is upon recommendation 63 of the Legislative Guide. The draft recommendation has been revised to avoid repeating the substance of recommendation 63 and to clarify the link with that text.

32. Recommendation (10) (previously draft recommendation [13] of A/CN.9/WG.V/WP.76) has been revised in accordance with the decision of the Working Group at its thirty-second session[18] and to indicate the link with the recommendations of the Legislative Guide.

Priority for post-commencement finance

33. The Working Group approved the substance of draft recommendation (11) (previously draft recommendation [16] of A/CN.9/WG.V/WP.76) at its previous session.[19] The recommendation has been revised to avoid repeating the substance of recommendation 64 and to clarify the link with that text. However, to the extent that recommendation (11) applies recommendation 64 to the group context without changing the terms of that recommendation, recommendation (11) might not be required and its content could instead be covered by a general recommendation to the effect that the Legislative Guide would apply to a group member in the same way as it would apply to a single debtor not a member of a group, unless changes are recommended in this work.

Security for post-commencement finance

34. Draft recommendation (12) (previously draft recommendation [17] of A/CN.9/WG.V/WP.76) was approved in substance at the previous session of the Working Group,[20] based as it is on recommendation 65 of the Legislative Guide. The draft recommendation has been revised to avoid repetition of the substance of recommendation 65 and to clarify the link with that text, at the same time making it clear that a group member other than the member to whom the post-commencement finance is provided grants the security interest.

35. As currently drafted, recommendation (12) does not indicate whether the group member granting the security interest is subject to insolvency proceedings. Recommendation (13), in contrast, specifies that the member granting the guarantee should be subject to insolvency proceedings. The Working Group may wish to consider whether draft recommendations (12) and (13) should apply in the same situation, i.e. that the member granting the security interest be subject to insolvency proceedings, and whether both recommendations should be subject to the conditions set forth in paragraphs (a) and (b) of draft recommendation (13).

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[17] A/CN.9/622, paras. 42-46.
[18] A/CN.9/622, para. 41.
[19] A/CN.9/622, para. 55.
[20] A/CN.9/622, para. 56.

Guarantee or other assurance for repayment of post-commencement finance

36. Draft recommendation (13) (previously draft recommendation [15] of A/CN.9/WG.V/WP.76) has been revised to take account of the concerns of the Working Group at its thirty-second session,[21] clarifying that it would apply to a group member subject to insolvency proceedings and not to a solvent member, and establishing the necessary conditions. In that regard, the previous subparagraph (a) concerning the receipt of benefit has been deleted as establishing a standard that would be too vague and therefore difficult to satisfy.

37. With respect to paragraph (b), the Working Group may wish to consider whether the recommendation sets a standard for approval of post-commencement finance that demands all creditors individually considered not be affected or rather that the court should make an overall evaluation, taking into account the interests of creditors collectively.

38. If the Working Group is of the view that recommendations (12) and (13) should be subject to the same conditions, they may be combined into a single recommendation referring to the granting of "a security interest, guarantee or other assurance for repayment of post-commencement finance".

39. Draft recommendations [18] and [19] of A/CN.9/WG.V/WP.76 have been deleted on the basis that they repeated the text of recommendations 66 and 67 of the Legislative Guide.

4. Treatment of contracts

40. Paragraph 49 of document A/CN.9/WG.V/WP.76/Add.1 raises the issue of the application of recommendations 69-86 of the Legislative Guide, which address the treatment of contracts, in the case of insolvency of two or more members of an enterprise group, particularly where those contracts were entered into between group members. In particular, the Working Group may wish to consider the treatment with respect to continuation and rejection of contracts that have been entered into between two members of the group against which insolvency proceedings have commenced or between such a member and a solvent member of the group.

5. Avoidance proceedings

(References to previous UNCITRAL documents: A/CN.9/WG.V/WP.74/Add.1, paras. 46-48; A/CN.9/618, paras. 43-45; A/CN.9/WG.V/WP.76/Add.1, paras. 1-8; A/CN.9/622, paras. 61-65)

(a) General remarks

41. The recommendations of the UNCITRAL Legislative Guide on Insolvency Law relating to avoidance would generally apply to avoidance of transactions in the context of an enterprise group, although additional considerations may apply to transactions between members of the group. A significant expenditure of time and money may be required to disentangle the layers of intra-group transactions in order to determine which, if any, are subject to avoidance. Some transactions that might

[21] A/CN.9/622, paras. 47-54.

appear to be preferential or undervalued as between the immediate parties might be considered differently when viewed in the broader context of a closely integrated group, where the benefits and detriments of transactions might be more widely assigned. Those transactions may involve different terms and conditions than the same contracts entered into by unrelated commercial parties on usual commercial terms, for example, contracts entered into for purposes of transfer pricing.[22] Similarly, some legitimate transactions occurring within a group may not be commercially viable outside the group context if the benefits and detriments were analysed on normal commercial grounds.

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

43. Some of the transactions occurring in the group context may be clearly identified as falling within the categories of transactions subject to avoidance under recommendation 87 of the Legislative Guide. Other transactions may not be so clearly within the scope of recommendation 87 and may raise issues concerning the extent to which the group was operated as a single enterprise or the assets and liabilities of group members were closely intermingled, thus potentially affecting the nature of the transactions between members and between members and external creditors. There may also be transactions that are not covered by the terms of avoidance provisions. Some insolvency laws, for example, provide for avoidance of preferential payments to a debtor's own creditors, but not to the creditors of a related group member, unless the payment is made, for example, pursuant to a guarantee.

44. An issue that may need to be considered in the group context is whether the goal of avoidance provisions is to protect intra-group transactions in the interests of the group as a whole or subject them to particular scrutiny because of the relationship between group members. Transactions between members of a group might be covered by those provisions of an insolvency law dealing with transactions between related persons. The Legislative Guide defines "related person" to include members of an enterprise group such as a parent, subsidiary, partner or affiliate of the insolvent member of the group against which insolvency proceedings have commenced or a person, including a legal person, that is or has been in control of the debtor. Those transactions are often subject, under the insolvency law, to stricter avoidance rules than other transactions, in particular with regard to the length of suspect periods, as well as presumptions or shifted burdens of proof to facilitate

[22] For an explanation of transfer pricing, see A/CN.9/WG.V/WP.74, para. 1(m).

avoidance proceedings and dispensing with requirements that the debtor was insolvent at the time of the transaction or was rendered insolvent as a result of the transaction. A stricter regime may be justified on the basis that these parties are more likely to be favoured and tend to have the earliest knowledge of when the debtor is, in fact, in financial difficulty.

45. The Working Group may wish to consider whether (a) such contracts should be treated as being between insiders, as defined in the Legislative Guide; (b) the standards applying to contracts between unrelated parties should be applied to contracts entered into in a group context; and (c) whether recommendation 87 of the Legislative Guide is sufficient to address the treatment of such contracts in the group context.

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

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

(b) Recommendations

Avoidable transactions

(14) [20] The insolvency law should specify that, in considering whether a transaction of the kind referred to in recommendation 87 (a), (b) or (c) of the Legislative Guide that took place between related persons in a group context should be avoided, the court may have regard to the circumstances of the group in which the transaction took place. Those circumstances may include: the degree of integration between the members of the group that are party to the transaction; the purpose of the transaction; and whether the transaction granted advantages to members of the group that would not normally be granted between unrelated parties.

(15) [21] The insolvency law may specify that, with respect to the elements referred to in recommendation 97 of the Legislative Guide and their application in the context of a group, special provisions concerning defences and presumptions apply.

(c) Notes on recommendations

48. At its thirty-second session, the Working Group approved the substance of recommendations (14) and (15) as set forth above. It was suggested[23] that a

[23] A/CN.9/622, para. 65.

reference to fraudulent transactions be added to draft recommendation (19) (previously draft recommendation [20] of A/CN.9/WG.V/WP.76/Add.1). Recommendation 87 (a) of the Legislative Guide, which specifies the categories of transactions that should be subject to avoidance, was intended to cover fraudulent transactions, but a longer description of those transactions was adopted, focussing on particular characteristics of those transactions, rather than relying on broader labels such as "fraud", which might carry with them different interpretations or standards in different jurisdictions. See for example, Legislative Guide, part two, chapter II, para. 171.

6. Rights of set-off

(References to previous UNCITRAL documents: Legislative Guide, part two, chap. II, paras. 204-207 and recommendation 100)

49. The Working Group may wish to consider whether issues additional to those addressed in the Legislative Guide with respect to rights of set-off arise in the enterprise group context.