Multinational Corporate groups rescue in the EU--Theories, Solutions and Recommendations

A thesis submitted to the University of Manchester for the degree of Doctor of Philosophy in the Faculty of Humanities

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<tr>
<td>CoMI</td>
<td>Centre of main interest</td>
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<td>EIR</td>
<td>EU Regulation on insolvency proceedings 2000</td>
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<td>EIR recast</td>
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<td>MCGs</td>
<td>Multinational corporate groups</td>
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Abstract

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Degree title: Doctor of Philosophy
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This thesis is a study on solutions for cross-border insolvency of multinational corporate groups, with particular reference to the EU Regulation on insolvency proceedings recast 2015 (EIR Recast). Multinational corporate groups are important players in the modern business world; how to treat them in cross-border insolvency context has been hotly debated. The main issue is how to preserve the value of the group under circumstances where member companies in the same group are in more than one country and subject to more than one set of insolvency law. The existing solutions include substantive consolidation, procedural consolidation proposed by cross-border insolvency law scholars, market/hybrid legal solutions aiming to avoid group-wide insolvency, and the EIR recast which unprecedentedly provides 'group coordination proceedings' to respond to this issue as a procedural cooperation framework. All these solutions will be examined in this thesis in the light of insolvency law/cross-border insolvency law theories and multinational enterprises theories.

The aim of this thesis is to examine the existing solutions for cross-border insolvency of multinational corporate groups on the basis of a combination of insolvency law/cross-border insolvency law theories and multinational enterprises theories. The thesis starts from theoretical grounds of corporate rescue and argues that preservation of going concern value and respecting entity law are the goals of corporate rescue law. It further considers theories regarding multinational enterprises and its implications on developing cross-border insolvency solutions for multinational corporate groups.

With an understanding of relevant theories, the thesis examines the procedural consolidation solution which focuses on insolvency jurisdictional rules. The result is that procedural consolidation may not be in line with the reality of how the groups are operated and may not provide certainty to the creditors and market.

The thesis moves on to examine the market/hybrid legal solutions which purport to be able to avoid group-wide cross-border insolvency. It shows certain merits of these solutions and also reveals the limitations and uncertainty of them. Finally, it argues that a general insolvency cooperation framework-- the new group coordination proceedings-- is desirable to work as an alternative to the above-mentioned solutions with improved certainty. The thesis tries to improve the utility of the proceedings by providing a recommendation to one of their main weaknesses--the opt-out mechanism.
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Special thanks go to my wife Xiao Liu and my parents. Your steady encouragement and love keep me going forward.
Chapter 1 Introduction

1.1 Background and the value of this study

As the EU is undergoing an economic crisis, the number of insolvency cases reached a record level. The EU Commission has therefore been calling for reform of insolvency law both at national level and EU level to mitigate the further losses to creditors and stakeholders in recent years. Its current political priority is to promote economic recovery and sustainable growth, a higher investment rate and the preservation of employment, as set out in the Europe 2020 strategy for jobs and growth. To achieve this task, the EU believes that a rescue culture will help it to facilitate economic recovery.¹

As part of the new Europe 2020 strategies, the new EU Regulation on insolvency proceedings (EIR Recast)² focuses on the tasks of saving the economically healthy but financially distressed business.³ The European Commission believes that the benefit of business rescue is, among other things, maximisation of assets, higher recovery rate to creditors, and saving jobs.⁴ Also, the EIR Recast unprecedentedly provides a new mechanism for rescue of groups of companies: the group coordination proceedings.⁵ This may be seen as a milestone which reveals that the European Commission has acknowledged the benefit of rescuing groups of companies; also, it explicitly expresses the rescue culture of EU insolvency laws.

³ibid Recital 10
⁴The commission has acknowledged the benefit of business rescue, amongst other things, include maximisation of assets (preserve goodwill and know-how), higher recover rate to creditors(French liquidation 31% vs rescue 96%), and saving jobs. The main policy is devoted to encourage economic growth. Commission Staff working document, impact assessment, accompanying the document Revision of Regulation (EC) No 1346/2000 on insolvency proceedings SWD(2012) 416 final p7, p11 available at ec.europa.eu/justice/civil/files/insolvency-ia_en.pdf
⁵EIR recast 2015 Chapter V Section 2
The scope of new EU regulation on insolvency proceedings is expanded so that it encompasses rescue proceedings of member states. The European Commission's working paper and member states' rescue-friendly legislations could be seen as a common consensus aimed to support a rescue culture.

Many member states recently updated and reformed their insolvency law to respond to this change. In the UK, the Cork Report first stressed the rescue culture and elucidates that the aim of rescue should consider a broader scope of interests. The Enterprise Act 2002 put corporate rescue as the foremost goal for administrators to fulfil. On 22 September 2011, the Spanish Congress passed the reform of insolvency law, which provides pre-insolvency solutions that aim to prevent insolvency. Germany recently introduced its reformed insolvency procedures--‘ESUG’-- on 1 March 2012 for the purpose of pursuing stable economic policy, preserving jobs and in turn benefiting the public. France also approved a very deep reform to its insolvency law which encompasses the pre-insolvency proceedings, accelerated financial safeguard proceedings, safeguard proceedings and restructuring proceedings. All these examples imply that the EU has entered an era of corporate rescue both at EU level and national level.

On the macro level, the insolvency of large corporate groups has a far-reaching impact on the European economy. Large corporate groups produce 30% of the jobs in the EU and

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6 EIR recast 2015, Article 1  
8 Bernardino Muñiz, 'New restructuring regime in Spain' Eurofenix spring 2012 p1  
9 The new features, among other things, include a three-month cap on the time limit which aims to urge that a viable restructuring plan of one financial distressed company could be submitted early by debtor. Also, interim protection order may be made by court to prevent creditors interrupt the restructuring plan during such period. Gerret Höher ‘ESUG: German for ‘Modernising Bankruptcy Law’ (2012) Eurofenix Spring p19  
10 Jean-Luc Vallens, 'Reforms planned in France' (2014) Eurofenix spring p26
produce 41% of gross added value.\textsuperscript{11} On the micro level, large multinational European corporate groups typically operate through the network of subsidiaries;\textsuperscript{12} when parent companies or subsidiaries face financial difficulties, the other companies in the same group may also suffer.\textsuperscript{13} All this shows that it is important to have desirable group solutions.

A frequently mentioned example of a cross-border insolvency case regarding multinational corporate groups is the insolvency of KPNQwest N.V.\textsuperscript{14} The main business of the group is in the telecom industry and it consists of many European subsidiaries. The value of the whole business relies on the integration of its underground cables in different member states. As at that time no cross-border insolvency solutions were available for multinational groups of companies, the KPNQwest N.V. group fell into fragmented insolvency proceedings and therefore the value of the whole business could not be preserved. This shows that it is important to provide cross-border insolvency solutions for multinational corporate groups (MCGs).

Cross-border insolvency of multinational corporate groups (MCGs)\textsuperscript{15} is a relative new topic and it is the point where private international law, insolvency law and multinational enterprise theories meet. There are no overarching cross-border insolvency theories and

\textsuperscript{11} Commission staff working document executive summary of the impact assessment - accompanying the document-commission recommendation on a new approach to business failure and insolvency SWD(2014) 61 final p20
\textsuperscript{12} ibid p20
\textsuperscript{13} Commission staff working document executive summary of the impact assessment - accompanying the document-commission recommendation on a new approach to business failure and insolvency SWD(2014) 62 final p2
\textsuperscript{15} Multinational corporate groups are the main research target in this thesis. It means a group of companies that conduct business in more than one member state in the EU. The reason why the thesis chose corporate groups as the target is because companies have the independent legal status which creates particular challenges to cross-border insolvency law. Each member company may have its own creditors, assets; each subsidiary may be subject to a different insolvency jurisdiction. This thesis aims to deal with these issues.
law for multinational corporate groups in this area. Academics and insolvency practitioners propose to provide either theoretical solutions or pragmatic solutions. It is submitted that solutions for cross-border insolvency of MCGs may include private/hybrid legal solutions, substantive consolidation, procedural consolidation, and procedural cooperation.  

Cross-border insolvency law deals with the insolvency issues of single companies at an international dimension by means of allocation of insolvency jurisdiction and choice of law. The existing cross-border insolvency theories correspond to the values that corporate rescue insolvency law aims to pursue—certainty and value maximization. They aim to allocate jurisdiction and choice of law in a way that could help achieve these two goals.

It is generally believed that the issue of cross-border insolvency for MCGs result from the fact that one MCG consist of subsidiaries in more than one member state; each member company may have its own assets and creditors and each one may be subject to a different national insolvency law. Creditors may not necessarily agree on a joint group rescue plan when the groups enter into insolvency. Under this circumstance, how to maximize the group value and how to provide rules with certainty are issues that need to be resolved.

Among other solutions, procedural consolidation has attracted great attention as being the potential solution for cross-border insolvency of MCGs. The existing literature

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16 Private solutions rely on contracts; creditors and debtors may renegotiate a new deal such as debt waiver to avoid triggering insolvency proceedings. Hybrid legal solutions are combination of private solutions and legal solutions, such as pre-pack sale of business.

17 Robert van Galen, ‘Insolvent groups of companies in cross border cases and rescue plan’ (2012) Report to the Netherlands Association for Comparative and International Insolvency Law

generally assumes it is desirable to centralize the insolvency proceedings of group
member companies, for example into one court. These solutions mainly focus on cross-
border insolvency jurisdictional rules; it is generally believed that procedural
consolidation can achieve a successful group reorganization result.

However, the existing cross-border insolvency law literature may ignore the multinational
enterprise theories regarding the value of MCGs and how MCGs obtain such value.

Without understanding the characteristics of MCGs, it is difficult to examine the proposed
cross-border insolvency solutions for MCGs. This thesis tries to fill in this gap. It
examines the three main solutions for cross-border insolvency of MCGs in the light of a
combination of insolvency law theories, multinational enterprise theories and cross-
border insolvency law theories.

This thesis sets the EU regulation on insolvency proceedings (EIR recast) as the
background with regard to insolvency jurisdiction rules and choice of law.19 Also, the
thesis examines the 'group coordination proceedings' in EIR recast as being the first rules
concerning cross-border insolvency law of MCGs.20

One limitation of EIR recast and also the thesis is that the insolvency of financial
institutions such as banks or insurance companies which could create systemic risks will
be excluded from this study. These financial companies are subject to separate principles
and regulations.

19 The New EU regulation on insolvency proceedings which was drafted in 2015 and will come into effect
in 2017 introduce a group coordination proceeding for group insolvency. EIR recast embodies cross-border
insolvency law in the EU which is designed to allocate insolvency law jurisdiction, choice of law and set
recognition and enforcement rules among member states.
20 Gerard McCormack, ‘Something Old, Something New: Recasting the European Insolvency Regulation’
(2016) 79(1) MLR

15
The author is aware of the Brexit incidence. Because the research ended prior to the referendum, detailed analysis of the influence of Brexit is out of the scope of this thesis. Also, as this thesis focuses on examining and analysing solutions for MCGs with reference to EIR recast, the relevant discussions and arguments are still useful as long as the EU exists, whatever part the UK plays in it. How much impact Brexit will cause on the EU remains to be seen. If Article 50 is triggered in the near future, it may mean that EIR recast will not be applicable to the UK unless a new agreement between the UK and the EU is concluded.21 As the cross-border insolvency solutions of MCGs are important to both the UK and the EU, it would be desirable to see an agreement with similar functions being drafted.

1.2 Research questions and contributions

The central research question of this thesis is; 'Whether the existing solutions for the cross-border insolvency of multinational groups of companies are desirable in the EU?' In addressing this central research question, two tasks will be conducted in order:

1. How should insolvency law theories, groups of companies theories and cross-border insolvency law theories collectively respond to cross-border insolvency of MCGs? The thesis examines MCGs with reference to multinational enterprise theories. In particular, it considers MCGs through a new perspective: the business network perspective. This perspective sees MCGs as a network whereby resources and information can be transferred through it. It argues that MCGs may have group going concern value in the relationships among member companies. For the purpose of achieving the goals of

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21 One main effect following Brexit may be that the insolvency proceedings which are opened in the UK will not enjoy automatic recognition by other courts of EU member states. Chris Birch and Victoria Procter, 'Brexit – implications for the UK restructuring and insolvency market'2016 at https://www.eversheds.com/documents/services/commercial/Brexit-implications-for-UK-restructuring-and-insolvency-market.pdf p4; Ken Baird et al, 'Brexit: What does it Mean for Restructuring and Insolvency?'2016 at https://www.law.ox.ac.uk/business-law-blog/blog/2016/07/brexit-what-does-it-mean-restructuring-and-insolvency. Another is that EIR recast introduces a group coordination proceeding as a framework for MNCs. The UK may not be able to use this coordination framework after Brexit. All these may make the UK less popular as a restructuring and insolvency jurisdiction than before.
insolvency law theories and cross-border insolvency law theories, it is desirable to preserve the relationships of member companies in MCGs.

However, the goal of value preservation needs to be balanced with the goal of certainty. For the purpose of gaining group going concern value in a given MCG, certain head office functions have to be allocated at subsidiary level. This may have implications on the insolvency jurisdiction rule—centre of main interest (CoMI) – which is defined as the place where the head office functions are carried out. Therefore, one should not only respect the legal independent identity of group members (each has its own creditors and assets); but one also needs to respect each subsidiary's insolvency jurisdiction.

2. The second task is to examine the existing solutions of cross-border insolvency of groups of companies—procedural consolidation, market/hybrid legal solutions and procedural cooperation and coordination—on the basis of the theories shown above. In particular, the task is to examine whether the existing solutions can preserve group going concern value and provide certainty.

With the insight gained from analysis of theories, this thesis firstly aims to contribute to the existing literature by considering whether the hotly debated procedural consolidation can be a reliable solution. The thesis argues that there is considerable uncertainty to allocating insolvency jurisdiction of the group members into one court, such as the group CoMI approach.\(^\text{22}\) The goal of certainty may indicate that procedural consolidation can only be applied limited cases.

\(^{22}\) See Chapters 3, 4
Some market/hybrid legal solutions may avoid a group-wide insolvency by renegotiation of debt agreements or by a pre-pack sale. If the capital structure and joint debt instruments allow these solutions to be executed, these solutions are desirable as they only preserve the group going concern value, but also based on consensual agreement or clear cram-down tools. Nonetheless, the thesis also identifies the limitations of market/hybrid legal solutions. For example, the fragmented categories of debts and creditors cause significant challenges to private solutions. Also, where the debts are not arranged by holding companies and the profiles of creditors in different subsidiaries are different, parties may not be able to avoid a group-wide insolvency by modification of their loan agreements. As in the latter cases, creditors of different profiles may not be subject to a joint inter-creditor agreement. Also, the drawbacks of a pre-pack sale may not always provide creditors with a high level of recovery.

In the light of the drawbacks and limitations of the above mentioned solutions, the thesis argues that the group coordination proceedings in the EIR recast may play a role in filling in this gap. However, the current EIR recast group coordination proceeding has a notable weakness, namely the opt-out mechanism. Such rule could be invoked without limitation, allowing subsidiaries to be pulled out of a group plan, or without even considering the group plan. This is particularly true as senior creditors may control the subsidiaries by providing refinancing or buying debt from the debt market, so it is possible for them to control certain important subsidiaries and to holdout or conduct a fire sale without cooperation from other group companies. The thesis considers the option of harmonization of insolvency law in the EU as a way to fix the drawbacks of national law and facilitate cooperation. However, due to the significant difficulties to do so, the thesis opts for a modest option.
Based on the conclusion examined in Task 1 above, the thesis also argues that it is difficult to achieve the goal of preservation of group going concern value in the light of the opt-out mechanism. As a result, the thesis makes an original modest recommendation to group coordination proceedings by providing that EIR recast provisions need to create an atmosphere that encourages parties to consider a group rescue plan. This can be done by interpreting the Article 56 and recital 58 in the EIR recast as a limitation on the invocation of the opt-out mechanism. Article 56 and recital 58 require insolvency practitioners to exchange information and consider the possibility of coordinating members' insolvency proceedings rescue options at an early time. One may therefore argue that that requires insolvency practitioners to exchange information and consider the possibility of a group rescue plan at an early stage.

This requirement may act as a constraint on the invocation of the opt-out mechanism so that certain abusive strategies of local senior creditors could be mitigated and better solutions may be available to all the relevant parties. The requirement can be obtained as a purposive way of interpretation of existing provisions of EIR. By encouraging the exchange of information and considering a group rescue early, the possible low pre-pack sale price of one subsidiary will be checked against its value from a group going concern sale price. This will in turn improve the effectiveness of EIR group coordination proceedings by reducing the information asymmetry.

1.3 The Aims of thesis

The aim of this thesis is to explore the possible solutions for the cross-border insolvency of groups of companies in the EU. This main objective can be divided into two sub-objectives: 1) analysing theories of corporate rescue law, cross-border insolvency law and
multinational enterprise law; 2) analysing existing solutions of cross-border multinational corporate groups rescue.

In the first theoretical sub-objective, the aim is to examine what values do we expect to embrace and how should these values be balanced (Chapter 2). The thesis achieves this sub-objective by examining three groups of theories: insolvency theories, groups of companies theories and cross-border insolvency theories. This task aims to pave a theoretical ground for further analysis of different practical solutions for cross-border corporate rescue for multinational corporate groups.

Corporate rescue theories reveal two underlying values that corporate rescue law should pursue: preservation of going concern value and certainty. With regard to going concern value, multinational enterprise theories provide insight regarding how such going concern value is formed in multinational corporate groups and implicate the way how the value should be protected in a cross-border insolvency context. Cross-border insolvency add another layer of complication as different countries have different sets of insolvency law. In this regard, cross-border insolvency theories try to reconcile the values of corporate rescue law with the fact that creditors in differing member states may be subject to different protection. One may infer that the certainty value extracting from corporate rescue theories requires that the insolvency jurisdiction of each subsidiary in one given cross-border corporate group to be respected. A desirable solution for multinational corporate groups rescue should respect each entity in the groups and meanwhile be able to preserve the value of the whole groups. Therefore, the research of this theoretical sub-objective provides a good understanding of the interaction of these theories and allows
further analysis of existing practical solutions for cross-border insolvency of multinational corporate groups.

When it comes to the second sub-objective, the thesis starts to examine the procedural consolidation (Chapter 3), market/hybrid legal solutions (Chapter 4) and procedural cooperation and coordination solutions (Chapter 5). All these existing solutions may have various degree of capacity to preserve the value of corporate groups in a cross-border corporate rescue context. However, every solution may have its own drawbacks or limitations which prevent it from balancing all the values that the theories would like to achieve. One important question that this sub-objective will examine is whether procedural consolidation and private/hybrid solutions are adequate to achieve the goals of preservation of value and certainty in the light of above-mentioned theories. If not, one may argue that there is a role that procedural cooperation and coordination can play. In terms of procedural cooperation and coordination, this thesis examines the group coordination proceedings in EIR Recast 2015. The purpose is to explore whether it is a desirable answer to cross-border multinational corporate groups rescue and the thesis provides a recommendation to improve their efficacy.

1.4 Methodology

The thesis adopts a theoretical/doctrinal approach to examine the desirable solutions for cross-border corporate rescue for multinational corporate groups in the EU. This task will be done in three steps by examining three groups of theories. The first groups of theories are corporate rescue theories; the second groups of theories are multinational corporate group theories; the third groups of theories and doctrines are cross-border insolvency theories and universalism/territorialism doctrines shaped mainly by EU cases. The interaction and implication of insolvency theories, cross-border insolvency theories and
groups of companies theories on cross-border insolvency of MCGs will be examined in order.

The insights gained from the analysis of these theories allow the author to examine procedural consolidation, market/hybrid legal solutions and procedural cooperation solutions for cross-border insolvency of MCGs in the EU. The reason to choose these three categories of practical solutions is that they can represent the existing typical solutions which have the ability to preserve group value in cross-border corporate group rescue context. Through the analysis of all these solutions in the light of above-mentioned theories, the thesis makes one recommendation to improve the 'group coordination proceedings' under the EIR recast.

1.5 Structure of thesis

The purpose of Chapter 2 is to explore the rationale of corporate rescue law and the theories of MCGs. It then examines the implications of corporate rescue law on the insolvency of MCGs. Without understanding the purposes of corporate rescue law, it is difficult to know what goals that a desirable solution for insolvency of MCGs should pursue. Chapter 2 introduces key concepts such as financially distressed companies and going concern value. Second, it explores the raison d'être of corporate insolvency law – preservation of going concern value of the distressed business. Also, the chapter engages in a discussion of theories of corporate rescue law and argues that the goals of corporate rescue law should be preservation of going concern value and certainty. The chapter finally examines the multinational enterprise theories and concludes that MCGs may have group going concern value in the relationships among member companies; this value should be preserved. On the other hand, the independent legal personality of group member companies and their respective insolvency jurisdiction should be respected due to the certainty requirement.
Chapter 3 focuses on the analysis of procedural consolidation. Procedural consolidation is a solution proposed for cross-border insolvency of MCGs; it aims to allow the whole group to come to one court to resolve cross-border insolvency issues.

To examine the desirability of procedural consolidation, the chapter starts from an introduction of cross-border insolvency theories—territorialism and universalism. Universalism supporters believe that the insolvency of one company should be subject to only one court and one set of insolvency rules—the law of centre of main interest (CoMI) of the company. By comparison, territorialism supporters assert that any court where the assets of the distressed companies are located can exert insolvency jurisdiction. For the purpose of understanding which paradigm can offer better certainty, Chapter 3 discusses the issue of forum shopping and the vulnerability of the CoMI to forum shopping.

By analysis of the abilities of the two paradigms along the lines of preservation of value and predictability, a conclusion can be drawn that the universalism has advantages over territorialism.

Universalism is increasingly gaining support. EIR recast adopts this the concept of CoMI as the insolvency jurisdiction rule of companies in the EU. According to the statutory and case definition, CoMI means the place where the head office functions of a company are carried out.

To achieve procedural consolidation for a MNC, one has to find the location of the group CoMI so as to open insolvency proceedings for group members. With the help of group theories in Chapter 2, Chapter 3 can examine whether the group CoMI could be
indentified in a predictable way. One contribution of the thesis is that, by using resource-based theory, knowledge-based theory resource dependence theory and business network theory, the Chapter analyses the relationships between parent and subsidiaries. The business network perspective particularly discusses the allocation of head office functions between subsidiaries and parent company, which in turn affects the jurisdiction of insolvency proceedings of companies under the EU Regulation.

The business network perspective\textsuperscript{23} is relevant in that large European corporate groups typically operate through the network of subsidiaries.\textsuperscript{24} The business network perspective could lend itself to this question by analysing the control thereof. It is one thing that one subsidiary in the group is influenced by its parent company and other group members; it is another thing that such subsidiary may also be delegated head office functions and that it can affect others. The implication is that group CoMI concept may be problematic due to its uncertainty and its inconsistency with the reality of the situation.

The proposed cross-border insolvency theories generally aim to achieve procedural consolidation by assigning jurisdiction to the court of group CoMI in an ex ante way. Cooperative territorialism (which argues that every court should have jurisdiction over all the assets in its territory), modified universalism (which enunciates that the court that


\textsuperscript{24}Commission staff working document executive summary of the impact assessment- accompanying the document-commission recommendation on a new approach to business failure and insolvency SWD(2014) 61 final p20
possesses the centre of main interest of the group should have jurisdiction) and universal proceduralism (similar to modified universalism, it argues that insolvency jurisdiction should be allocated to the group CoMI; the substantive insolvency law of one group member should be the law where its individual CoMI is located; that is to mitigate the contradiction between the court where the group CoMI is situated and the court where the individual CoMI is situated) are examined in turn.

The result is that the proposed cross-border insolvency group theories invariably rely on a group CoMI approach which brings in too much uncertainty. The viable way arguably may be modified universalism applied only to a single company, meanwhile cooperation and coordination between courts and insolvency practitioners should be enhanced.

By contrast, certain ex post ways of procedural consolidation by interpretation of CoMI or forum shopping are also discussed. The conclusion is that procedural consolidation may only be applied in limited cases.

Chapter 4 examines the market/hybrid legal solutions and protocols for cross-border insolvency of MCGs. The aim of Chapter 4 is to assess whether the market/hybrid legal solutions have provided desirable solutions to the cross-border insolvency of groups of companies. It shows that market and contracts cannot completely replace insolvency rescue tools due to the market failure and hold-out issues. Different from procedural consolidation which relies on insolvency jurisdiction rules, market/hybrid legal solutions focus on renegotiation of debt agreements or the transfer of the whole business to senior creditors. This may provide advantages of keeping the relationships within MCGs intact. Also, creditors will take actions by following the terms in the inter-creditor agreements which they all agreed before. As a result, one may argue that market/hybrid legal solutions may have potential to preserve group going concern value and certainty.
After acknowledging the merits of some market/hybrid solutions which can prevent group-wide insolvency and preserve group going concern value, the limitations of these solutions are also identified. The conclusion is that the market solutions are increasing difficult due to the fragmented categories of debts and creditors. The success of some market solutions, such as renegotiation of debts at holding companies level relies on the presence of concentrated debt instruments. Other private agreement between parties such as protocols are also vulnerable due to its contractual nature. It is therefore desirable to have a general framework to support cross-border insolvency for groups of companies.

Chapter 5 discusses the new group coordination proceedings, and provides a recommendation to improve its low efficacy. It has been identified that though group coordination proceedings respect the entity law which provides more certainty, their efficacy may be dampened if every group member is free to opt out of group coordination proceedings. As certain creditors or investors with better information may have the ability to control the subsidiaries, they may use opt-out mechanisms to extract value from other creditors.

Chapter 5 also analyses the possibility of harmonization insolvency law. On the one hand, uniform insolvency law may help mitigate the potential for abuse by national insolvency tools; one the other hand, the harmonized rules may facilitate cooperation and coordination between courts and insolvency practitioners. However, insurmountable difficulties of harmonization of insolvency law at the EU have been revealed. Such a solution may be too radical to be achieved now.
The thesis proposes a modest solution. The problem of the status quo is that even though the group coordination plan is desirable to all the creditors, it can be blocked by local senior creditors easily through opt-out. The discussion is rare in this regard. It is generally believed that opt-out mechanisms could be invoked without any limitation. However, one limitation on such opt-out could be found: EIR recast requires insolvency practitioners to consider group rescue plans. The better way to interpret this provision is that insolvency practitioners in the group are required to consider a group plan in the first place when they start to consider an individual plan. If they do not have the ability to do so, they need to inform other companies that an individual plan is being negotiated so that other companies with better information can consider the possibility of a group plan. This is because without considering the group plan, the group going concern value will be lost.

Local senior creditors who can control the subsidiaries may have an incentive to undervalue the subsidiaries so as to extract value from junior creditors. By considering group options, they have incentives to overvalue the subsidiaries to corporate group bidders so as to extract value from corporate group bidders. This competition facilitates the flow of information which benefits creditors in general. By doing so, the more information can be disclosed in a timely manner and more bidders may offer a price against the group going concern value. This allows the local insolvency practitioners to assess the group plan or the individual plan and decide which is a better offer to the creditors of the subsidiaries to which the insolvency practitioners have been appointed.

Chapter 6 concludes the main arguments of this thesis and suggests the direction of further development.
Chapter 2 Theoretical basis of corporate rescue and implications on rescue of multinational groups of companies

In Chapter 2, this thesis aims to deal with the first sub-objective articulated in Chapter 1 — the examination of the corporate rescue theories and multinational corporate groups theories. This Chapter aims to answer the questions: why do we need to provide special solutions for MCGs? Or why it is desirable to rescue MCGs? Also, what values are expected to be achieved in the rescue of MCGs? These values may then be used as benchmarks to analyse the drawbacks and merits of the existing cross-border insolvency law theories and practical solutions for the cross-border insolvency of MCGs.

The purpose of the above exploration is to examine the theoretical basis underpinning the corporate rescue regime and its implications to the cross-border insolvency of MCGs. By engaging in the debate on the significance of corporate rescue between economic school and traditional school insolvency theories, this chapter tries to argue that preservation of going concern value and certainty are the goals that corporate rescue law generally pursues. It further finds out a connection between corporate rescue law theories and multinational enterprise theories: multinational enterprise theories shed light on the existence of group going concern value and how such value is formed in MCGs. As a result, for the purpose of achieving the goals of corporate rescue law, one needs to consider the implications of multinational enterprise theories. The final implication will be further connected to the cross-border insolvency law theories in Chapter 3.

25 Compared to corporate rescue, liquidation may in many cases be a more straightforward solution. By liquidation proceedings, subsidiaries of MCGs can simply be liquidated separately in their respective countries without the need to design any tools and mechanisms for them.
26 See Chapter 3.
2.1 Theoretical views of corporate rescue

This section tries to explore the purpose of corporate rescue on the basis of insolvency law theories. Economic insolvency law theorists and traditional insolvency theorists hold different views regarding the value of corporate rescue. The aim of this section is to examine what are the values corporate rescue law should pursue; these values are benchmarks by which groups of companies' rescue practices and theories need to abide.

2.1.1 Corporate rescue and going concern value

Before entering into the debate between different schools of insolvency law regarding the goals of corporate rescue law, it is helpful to examine some key concepts.

It is generally believed that going concern value\(^{27}\) may exist only when a company is kept intact and running.\(^{28}\) In other words, an operating company may be worth more intact than if it is broken up.\(^{29}\)It is believed that the going concern value of a business is much larger than the piece meal value in liquidation proceedings; therefore, releasing going concern value is in the interests of all the creditors and stakeholders.\(^{30}\)Even though in many cases certain categories of creditors, such as unsecured creditors may be far from being fully compensated, the ‘enlarged pie’ available for distribution following the rank of creditors is a better deal for the creditors in general.

\(^{27}\) See definition of going concern value: Going-concern value is the value of a company as an ongoing entity. This value differs from the value of a liquidated company's assets, because an ongoing operation has the ability to continue to earn profit, while a liquidated company does not. At http://www.investopedia.com/terms/g/going_concern_value.asp


\(^{29}\) Douglas G Baird and Robert K Rasmussen, 'the end of bankruptcy' (2002)55 Stan L rev 751 p758

\(^{30}\) The rationale behind corporate rescue procedures, such as CVA or administration procedure in UK insolvency act is to release the going concern value of the potential business. London Department of trade and industry review (2000) p5
Resource-based theory\textsuperscript{31} and knowledge-based theory provide good insights into going concern value. From resource-based theory, if a company would like to achieve success in a market, it needs to obtain certain resources that are rare and idiosyncratic. Such resources can be the relationships that the company has formed with its suppliers and customers.\textsuperscript{32} Because of these relationships, the distress of one company may lead to one widely felt on the parties linked with this company, and legislators have long been aware of this effect to the wider world.\textsuperscript{33}

However, it is possible that the company does not have the capacity to coordinate different resources and relationships. From knowledge-based theory,\textsuperscript{34} the capacity of a given company to use the knowledge and the capacity to transfer and coordinate different knowledge are also important resources.\textsuperscript{35} As the capacities are conducted by people of companies, this shows that certain employees and managers in one company or a group of companies are also key assets.\textsuperscript{36}

\textsuperscript{33} Peter. Dahlin and others, 'Netquakes-- Describing Effects of Ending Business Relationships on Business Networks' Working Paper to be presented at IMP 2005 Rotterdam p5
\textsuperscript{35} Bruce Kogut, Udo Zander, 'Knowledge of the firm and the evolutionary theory of the multinational corporation' (1993) Journal of international business studies, Fourth Quarter p625
The possession of rare resources and the capacities to use the resources together allow one company to be more efficient than others as the company can use its assets in the most productive way.\textsuperscript{37} The companies which do not possess the rare resources or capacities will not be able to win competitors which can use them to produce more profits in the market.\textsuperscript{38} As a result, these companies may suffer negative cash flow and become insolvent in the future. Due to the rare resources and capacities, the additional value that the efficient company can gain can be considered as the going concern value of that company.\textsuperscript{39} Therefore, efficient companies generally have going concern value.\textsuperscript{40}

Where the assets are held and used in an inefficient way in a company, the company cannot generate profit to cover its operating costs. This is because the market punishes inefficient companies and screens them out. The longer the companies of the latter kind are kept alive, the more costs they are going to incur.\textsuperscript{41} This type of company is called an economically distressed company; in general it should not be rescued, as it has no going concern value. Economic distress denotes that a company may not survive in the market even if its temporary financial issue could be cured. In other words, its business plan is flawed. For example, it does not possess competitive people, information, resources, networks, or at least their combination does not work. Economically distressed companies should be sifted out by the market, as even if they can overcome their current financial difficulties, they will return back to financial distress due to an inherent lack of

\textsuperscript{38} Michelle J White, 'Does Chapter 11 save economically inefficient firms' (1994) 72 Wash. U. L. Q. 1319 p1319
\textsuperscript{39} Michelle M. Harner, 'The value of soft variables in corporate reorganizations' (2015)U. Ill. L. Rev. 509 p512
\textsuperscript{40} The efficiency means the maximization of the wealth of society. In the insolvency context, the ex post efficiency can be achieved if the value of distressed companies can be maximized. the ex ante efficiency can be achieved if insolvency law does not create incentives to stakeholders to engage in inefficient activities. Robert K. Rasmussen, 'The efficiency of chapter 11' (1991) 8 Bankr. Dev. J. 319 p323
competitiveness. Keeping such companies operating will decrease, not increase the value available to creditors in general.

By contrast, if companies can generate net profit but temporarily cannot satisfy their debt obligations, they are worth giving a chance to restructure their capital structure. This type of company is called a financially distressed company. Financially distressed companies are those facing liquidity difficulties. The reasons behind financial distress are various and are not always the fault of the companies; for example, they could be due to a temporary down-turn of the market or a currency fluctuation. Generally speaking, it is likely that the financially distressed companies are competitive and deserve a change to overcome their temporary liquidity issues. They have going concern value in that the longer they can be kept alive and operating, the more profit they could generate for creditors in general.

To preserve the going concern value, the key is to keep the business intact and operating. Breaking a company with going concern value into pieces may destroy the 'key resources' and the capacities of that company. For the purpose of keeping the business intact, two ways may be available: corporate rescue and business rescue. Corporate rescue involves a compromise between debtors and creditors, so that the debtor per se is still alive with its capital structure issues sorted out. By contrast, business rescue may involve a sale of the business to the third parties, so that the shell of the distressed debtor is 'dead'.

However, the viable business of the company may be bought as a whole by new owners. This can also save jobs and reduce externalities of insolvency.45

Business rescue focuses on preserving the business of the debtor rather than debtor itself. It embodies a sale to either the pre-insolvency stakeholders or a third party from the market.46 Practically, a sale may be the only solution to rescue the business, as the debtor might not be able to find alternative way to get rid of debts.

One may argue that corporate rescue is to conduct a necessary major intervention to salvage the failure of companies47 or business. The major intervention indicates that the action is urgent; that is, it aims to prevent a significant decline in the business’s fortunes.48 The value of an insolvent company will quickly disappear, so a fast decision-making is necessary to preserve the going concern value of the company. To conduct a company rescue, accurate information regarding to the distressed company is a must.49 The difficulty is that administrators are rarely sure about all details of the distressed company, so they choose business rescue as a fast solution; that is how business rescue became the prevalent type of rescue in practice.50 Insolvency Law Schedule B1 para.4 prescribes that: 'The administrator of a company must perform his functions as quickly and efficiently as is reasonably practicable.'51

Company rescue requires that the identity of the company is preserved, though in practice it is very difficult as the company cannot pay back all it owes to stakeholders.52 Company

45Vanessa Finch, Corporate insolvency law perspectives and principles (Second Edition Cambridge university press 2009) p244
47Alice. Belcher, Corporate rescue (Sweet &Maxwell London 1997) p12
48ibid p12
50Vanessa Finch 'Control and co-ordination incorporate rescue', (2005)Legal Studies p396
51Insolvency Act 1986 B1 para4
52Alice. Belcher, Corporate rescue (Sweet &Maxwell, London, 1997) p23
rescue is the pure form of rescue, which has been put at the top of the hierarchy of goals for administrators in the Enterprise Act 2002.\textsuperscript{53} It requires the administrator to first seek to rescue the company as a going concern.\textsuperscript{54} However, this does not mean that corporate rescue is the ultimate aim that should be pursued at all cost.\textsuperscript{55} The Insolvency Act articulates that if a business rescue could achieve a better result to creditors in general, it should be given priority.\textsuperscript{56} Similar to the UK position, the US reorganization law chapter 11\textsuperscript{57} also moves from corporate rescue to business rescue for the purpose of benefiting a broad range of stakeholders.\textsuperscript{58}

In the case where one business has key relationships with suppliers or firm specific human capital, other buyers may not easily acquire such value by purchasing the business.\textsuperscript{59} For example, the replacement of directors may sacrifice key knowledge about supplier relationships which can lead to a loss to business.\textsuperscript{60} Therefore, in certain cases corporate rescue may be preferable to business rescue. However, both a successful business rescue and a company rescue could benefit many of the creditors and stakeholders.

The concept corporate rescue used in this thesis includes corporate rescue and business rescue; it refers to solutions which can preserve going concern value of either the distressed businesses or the companies.

\textsuperscript{53}Enterprise act 2002 Part 10 Para 3(1)
\textsuperscript{54}Mark. Phillips and Jeremy. Goldring, 'Rescue and Reconstruction' (2002) 15 Insolvency Intelligence p75- 76
\textsuperscript{56}Insolvency act 1986 B1 Administration Art.3(3) b
\textsuperscript{57}US Code Title 11 Bankruptcy Chapter 11 1978
\textsuperscript{58}Gerard McCormack, ‘Something Old, Something New: Recasting the European Insolvency Regulation’(2016) 79(1) MLR P125
2.1.2 The debate between the economic account and the traditional account of insolvency law

2.1.2.1 Debate on the preservation of going concern value

The economic account of insolvency law is of the opinion that insolvency law is designed to deal with common pool issues.\textsuperscript{61} By setting up a scene that the common pool issue is the unique problem that insolvency law needs to deal with, it then asks what solution these concerned creditors will come up with. The answer is a collective and compulsory insolvency proceeding imposed on parties’ individual actions. Without an insolvency system, the creditors with diverse interests have to monitor other creditors after lending money to the debtor, as they know that they have to compete with others. Therefore, the loan contract may involve significant uncertainty and the transaction cost will be high. Some creditors may also try to enforce their individual claims against distressed debtors, which will make an already gloomy situation worse.\textsuperscript{62} Insolvency proceedings reduce considerable monitoring and dispute costs for all creditors and, most importantly, preserve the going concern value of distressed companies.

The economic account suggests that insolvency law may redistribute certain value to other stakeholders only if doing so can preserve the going concern value. In other words, redistribution itself is not the goal of insolvency law; its purpose is to facilitate the

\textsuperscript{61} Assume that debtor runs a fish pool and the value of the fishes are not enough to pay back creditors. What would happen when the creditors are privy to the financial distress of debtor? They probably will compete with each other and grab as much the assets (within the limit of they are owed) of debtors as possible to compensate their debts. Such situation will happen without insolvency law. However, this chaotic situation may not help to preserve the going concern value, as creditors tear the debtor into pieces such that debtor can no longer operate on behalf of creditors. Insolvency law an instrument to maximise the assets of the distressed companies and distribute them to the creditors. Thomas H. Jackson, \textit{The logic and limits of bankruptcy law} (Harvard university press 1986) p11

\textsuperscript{62} Thomas H. Jackson, \textit{The logic and limits of bankruptcy law} (Harvard university press 1986) p10
preservation of going concern value.\textsuperscript{63} It is plausible to pay employees and suppliers in the course of reorganization as doing so can be the only way to keep the business intact. As the above section argues, going concern value can be made up by the relationships between debtor companies and suppliers, skilled managers and employees. To keep these relationships and employees is to keep going concern value. A straightforward liquidation may not be a solution;\textsuperscript{64} even though liquidation is also a collective insolvency law proceeding, it mainly aims to sell the components of the debtors while it does not aim to run the business for a period of time.

Traditionalists adopt a multi-value approach by arguing that the economic interest is not the only value insolvency law should pursue;\textsuperscript{65} insolvency law should pursue other values: preserving jobs, protecting other stakeholders besides creditors and protecting the community’s interests.\textsuperscript{66} The traditional account of insolvency law argues that the task of insolvency law is to deal with the defaults between one debtor and various creditors, and thereafter insolvency law needs to decide how to distribute the loss incurred from such default by considering their respective abilities to bear loss and risks.\textsuperscript{67} Conflicting interests among stakeholders give rise to a tough issue for bankruptcy law to resolve.\textsuperscript{68}


\textsuperscript{64} Going concern value exists in the operating of business, the corporate rescue procedures are hence necessary to fill in this gap. The corporate rescue procedures should respond to the common pool issues and preserve the value for creditors in general.


\textsuperscript{67} For example, certain employees except for managers do not have access to the financial information of the companies so that they have difficulties to predict the risks of the companies they are working; they also suffer severe hardship when they lost their jobs and thus incomes. Furthermore, employees are not experts to shield their risks, and rarely do they have more than one job to spread the risk of layoff. Elizabeth Warren 'Bankruptcy Policy' (1987) 54 U. Chi. L. Rev. 775 p777, p790; Donald R. Korobkin, 'Employee interests in bankruptcy' (1996) 4 Am. Bankr. Inst. L. Rev. 5 p12 arguing that the reason why company internalises employees is to reduce the cost, as employees may accept a lower than the market remuneration to conduct certain works. They may expect the other informal benefits from the company such as promotion opportunities. When a company is wound up, the direct affect to the employees, among other things is they heavily rely on their owed income to go by, and it is not easy for them to immediately find out another job.

\textsuperscript{68} It is more practical and views bankruptcy as 'dirty complex elastic and interconnected policies', thereby it is difficult, if not impossible, to elucidate insolvency policies. See Elizabeth Warren 'Bankruptcy Policy' (1987) 54 U. Chi. L. Rev. 775 p811
a result, insolvency laws become vehicles to redistribute the loss and risks which the different stakeholders need to bear.

Advocates of the traditional account believe the welfare of the community should also be considered in insolvency law. From their point of view, insolvency should not focus only on the maximization of creditors' interests. Rather, it is justified to redistribute certain interests of a distressed company in favour of other affected stakeholders such as the community that the company exist in. However, advocates do not endow a superior status to the community. The choices between rescue and liquidation still need to be judged in a business sense so as to sift out economically distressed businesses. Granted, sometimes the interests of communities may be difficult to measure, but that does not mean that we should never make efforts to protect them irrespective of their huge value.

Thus far, one may summarise that the economic account advocates believe that preservation of going concern value is the goal of insolvency law. By contrast, traditionalists aver that preservation of going concern value is not the only end; keeping distressed companies running on behalf of a broad range of stakeholders is the main purpose of insolvency law.

The issue here is not whether other stakeholders are affected by the insolvency of a given company; nor is it whether those negatively affected parties are worth protecting. The

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69 Vanessa Finch Corporate insolvency law perspectives and principles (Second edition Cambridge university press 2009) p40  
70 ibid p41  
72 ibid.p1033  
73 ibid.p1046  
75 It argues that different to other legal systems, bankruptcy law uniquely deals with the insolvency issues by providing a systematically structure and forum. The moral, political and social values are all aims merit protection. Donald R, Korobkin 'Rehabilitating Values: A Jurisprudence of Bankruptcy' (1991) Columbia Law Review, Vol. 91 4 p766
issue is how to protect them in a reasonable way. The economic account advocates set one pre-condition on rescue: the businesses should be financially distressed rather than economically distressed. The sound business plan of one financially distressed business shows that the business has going concern value which may be formed by other stakeholders such as employees and suppliers. Protecting their interests in the insolvency proceeding is in line with the goal of preservation of going concern value, and is in line with the interests of creditors.

By contrast, though, traditionalist also recognise stakeholders' support may be important to the preservation of business;\textsuperscript{76} they do not set up clear rules on when to protect a distressed business and how to balance different interests they propose to protect. Traditionalists insist that the continuance of distressed business per se is a good thing in itself.

Surely, the need to keep the going concern value gives rise to the necessity of running the business while the reorganization plan or the sale plan is in the drafting stage. This is especially true when the market is thin and the given distressed company cannot be sold immediately or no fair price can be secured.\textsuperscript{77} It is also possible that buyers may not want to buy the companies at fair value due to a lack of information. All these cases require insolvency rescue law to provide a platform allowing the companies to be run for a period of time so as to either recover or attract buyers.

But the caveat of the above is that if the distressed business has no going concern value, and if the relationships between stakeholders and debtor companies contribute no going concern value, should the business still be kept alive? It is in this situation that the economic account advocates and the traditionalists hold different views.

\textsuperscript{76}Donald R. Korobkin, 'Employee interests in bankruptcy' (1996) 4 Am. Bankr. Inst. L. Rev. 5 p7
If the relationships between distressed companies and stakeholders do not form going concern value, the relationships should be cut off and be allocated back to the market. The market will reallocate these resources to the places where they could be better used. One should not only see the loss from insolvency without considering the net effect of saving such loss.

Without a clear balance of multi-values that traditionalists propose to protect, traditionalists' bankruptcy law policies may run the risk of preserving the distressed companies with no going concern value solely for the purpose of protection of jobs and communities.\(^{78}\) Such a strategy may only offer short-term protection to employees and communities, as the resources formed by these relationships do not constitute any going concern value such that the companies could trade themselves out of difficulty by keeping them intact. As a result, it is not only the creditors who will suffer from this strategy due to the reduction of value of business, the employees and community will suffer as well due to inevitable insolvency in the near future.

Economically distressed companies which are destined to be screened out by the market should not be saved, as doing so will not maximize either the creditors’ value or the other stakeholders’ value. In other words, protecting other stakeholders can only be worthwhile when their participation in the distressed companies generates going concern value. Since stakeholders’ participation in the companies is part of the going concern value of the companies, protecting their interests is protecting the going concern value which can maximize the value of insolvent estate for stakeholders in general in the long term.\(^{79}\)


\(^{79}\)Michael C. Jensen, 'Value Maximization, Stakeholder Theory, and the Corporate Objective Function' (2001) Business Ethics Quarterly vol 12 (2)p17; see also Jill Solomon, Corporate governance and accountability (4th edition John Wiley& Sons Ltd. UK 2013) p20 (also see the third King Report on corporate governance in South Africa); Also, consistent with Company law, directors of companies to consider a wider range of stakeholders' interests, such as employees, suppliers, customers and communities.
contrast, solely pursuing the goal of reducing the impact of insolvency to other stakeholders irrespective of the existence of going concern value will do more harm than good.

One should therefore not underestimate the importance of the concepts of financial distress and going concern value suggested by the economic school. Traditionalists ignore the fact that stakeholders’ relationships with debtor companies may not form going concern value which in turn explains that the debtor companies have neither enough resources or capacities that are worth keeping intact. Saving such company will cost creditors dear and the final fate of the company is still insolvency. Preservation of such business is not to preservation of going concern value for the purpose of insolvency law.

To sum up, the aim of insolvency rescue mechanisms is to preserve the survival of viable financially distressed businesses or companies, (or parts of them). It is the going concern value of financially distressed companies that makes corporate rescue, as opposed to liquidation, a desirable option. The rationale behind rescue procedures is that only those financially distressed companies that have viable future, despite suffering temporary financial difficulties, should be saved. By contrast, companies which have no viable business should be sifted out by the market, so that the resources can be reallocated to better use. Giving too much sympathy to business without going concern value could

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Company Act 2006 bases such prescript on the enlightened shareholder value theory, which gives priority to the interests of shareholders, while accepting that other stakeholders’ interests should be respected as long as there is no conflict between shareholders’ and stakeholders' interests. Considering the stakeholders' interests will be the effective way to achieve the goal of interests maximisation of shareholders. Also, since the stakeholders’ interests need to be considered outside of insolvency, considering the stakeholders’ interests beside creditors’ interests is consistent with the non-insolvency requirements by law. See Company Act 2006 UK part.10 chapter 2 s. 172; Christine A. Mall in Corporate governance (4th edition oxford university press 2012) p76


be considered as keeping resources in an inefficient way, which is harmful to the society.

82 It can be argued that their assets should be sold to buyers who can use them more efficiently. 83 That is to say that insolvency law should respect the sifting function of the market to filter out the inefficient companies.

If corporate rescue law cannot effectively preserve going concern value of financially distressed companies, the creditors of them will suffer more loss. As a result, it is very likely that creditors will increase the price of capital as a way of adjusting of risks. This is a general cost to all companies, including the efficient ones. 84 The rise of interest rate will discourage investment made by creditors and reduce the wealth growth rate of society. This indicates that one cannot ignore the incentive created by the corporate rescue law. The next section will discuss it.

2.1.2.2 Debate on certainty of insolvency law

The economic account values the ex ante influence 85 of insolvency law, while the traditional account does not. 86 The economic account believes that insolvency law should respect non-insolvency law as a baseline, as alteration of non-insolvency law inside insolvency proceedings will provide stakeholders with incentives to conduct strategic behaviour thereby giving rise to cost of insolvency 87 and the high cost of borrowing.

83 ibid p102
85 In this thesis efficiency means the maximization of the wealth of society. Therefore, it is equally important to check whether corporate rescue law provide wrong incentives to people to conducting value decreasing activities.
interest rate.  

Strategic behaviours exist as certain stakeholders may be treated better or worse in the insolvency law proceedings. Assume that unsecured creditors are given the same priority inside the insolvency proceedings while they are not so blessed outside the insolvency; unsecured creditors will have incentives to file for insolvency proceedings without considering whether doing so will cause loss to other stakeholders. Unsecured creditors know that without insolvency proceedings, they will not obtain the same priority; they will open insolvency proceedings to serve their own interests. Similarly, secured creditors may try to delay insolvency proceedings by using their power on the debtors, if any, or avoid insolvency proceeding by trying to foreclose their rights well before the appearance of insolvency risk. All these strategic behaviours will lead to opening insolvency proceedings either too early or too late, which is harmful for the stakeholders in general. So corporate rescue law should try not to provide stakeholders' wrong incentives. It is generally submitted that the timing of opening insolvency proceeding plays an important role in insolvency. For example, opening insolvency too early may not be the optimal option as the possibility for a cheaper private restructuring may be available; opening insolvency too late may cause distressed business to lose much value and it could become too late to be reorganized.

On a micro level, the costs of strategic behaviours are generally harmful as the going concern value is reduced by them. On a macro level, the uncertainty of such strategies are

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90 Without value-decreasing strategic behaviours, stakeholders may be more cooperative to consider the options of corporate rescue. The going concern value of the distressed companies are largely intact; it may be the good time to start considering corporate rescue.
risks for creditors as they need to factor in the rate of interest rate at the point of lending.

Beside the problem of strategic behaviours, not respecting non-insolvency law entitlements of creditors also lead to the rise of interest rates. As mentioned before, if courts decide to save jobs and protect communities, even if the business is economically distressed, the uncertainty so caused will lead to a higher borrowing interest rate.\textsuperscript{92} The reason is that economically distressed companies cannot use resources efficiently so they may have negative net cash flow. The loss incurred from the operating of the inefficient companies will be borne by creditors while the employees and the community will get benefit from it. Saving economically distressed companies is tantamount to transferring value from creditors to communities, while creditors do not know when their support for the community will end. The unclear policies will dramatically raise the interest rates.

As low interest rates can help borrowers keep more profits and engage in more investment,\textsuperscript{93} it is desirable to reduce interest rates by respecting non-insolvency law in insolvency proceedings. In the business world, one thing that has to be borne in mind is that most companies are solvent.\textsuperscript{94} Therefore, certainty is a goal of insolvency law no less important than preservation of going concern value. This is the reason why insolvency law generally respects the pre-insolvency rights (with some exceptions which will be discussed later).\textsuperscript{95}

However, it seems possible for a radical advocate of the economic account to argue that the reorganization procedure itself is wrong as it always involves methods to modify pre-

\textsuperscript{92} For example the court may decide to rescue a distressed company even though it is economically distressed, for the purpose of preserving jobs or benefitting certain stakeholders.

\textsuperscript{93} Alan Schwartz, 'A Normative Theory of Business Bankruptcy' (2005) Faculty Scholarship Series. Paper 303 p1220

\textsuperscript{94} Richard V. Butler, Scott M. Gilpatric, 'A re-examination of the purposes and goals of bankruptcy' (1994) 2 Am. Bankr. Inst. L. Rev. 269 p277

\textsuperscript{95} Irit Mevorach, \textit{Insolvency within multinational enterprise groups} (OUP 2009) p111
bankruptcy entitlements of creditors.\textsuperscript{96} This is true as the opening of collective insolvency procedures may substitute individual creditors' actions under non-insolvency law; the 'stay' on individual creditors may constrain their ability to exert their entitlements under non-insolvency law. However, without such mechanism, insolvency law does not exist.\textsuperscript{97}

If insolvency law strictly conforms to non-insolvency law, one may conclude that there are something we should not expect insolvency law to do.\textsuperscript{98} That is, insolvency law should only consider the interests of contractual parties, but does not consider other non-contractual parties.\textsuperscript{99} Such a radical economic account thus adopts a narrow path when considering the insolvency law, which excludes the protection of other stakeholders, such as managers, employees and others inasmuch as they are not creditors.\textsuperscript{100} There are two problems with this radical point of view. One is that Insolvency itself is not an excuse to avoid non-contractual obligations. For instance, distressed companies still need to compensate the community regarding pollution clean-up fees\textsuperscript{101} in the context of corporate insolvency.\textsuperscript{102} Insolvency policies should not only focus on the protection of contractual relationships, but overlook non-contractual relationships.\textsuperscript{103}

\textsuperscript{97}Stephen Lubben, 'The overstated absolute priority rule' (2016) 21 Fordham J. Corp. & Fin. L. 581 p585
\textsuperscript{98}Thomas H. Jackson, The logic and limits of bankruptcy law (Harvard university press 1986) p2
\textsuperscript{99}Vanessa Finch Corporate insolvency law perspectives and principles (Second edition Cambridge university press 2009) p34
\textsuperscript{100} For example, employees’ interest can only be consider in insolvency law to the extent they are owed wages, which qualify them as creditors. Insolvency law may not consider any interest on behalf of them more than it.
\textsuperscript{101}Environmental protection act 1990 ss.26(1) and 82(2)
Another point about only being concerned about creditors is that it jeopardises relationships between debtor companies and those non-creditors who contribute to the going concern value that insolvency law aims to preserve. For the purpose of keeping suppliers and customers or other parties supporting the business, it is important for the business to pay them cash immediately after receiving their goods or service, or provide lien superior to other pre-insolvency creditors. A narrow focus on repaying money owed to managers and suppliers, without being concerned about maintaining these key relationships, may cause going concern value lost.

Nevertheless, it does not mean that insolvency law should protect non-contractual parties at the expense of creditors. Even if these parties are worth protecting, the question of how these parties should be protected in a cost-effective way inside insolvency law needs to be answered.

If courts reorder non-insolvency law entitlements for the purpose of protecting of jobs and the community without differentiating economic distress/financial distress and without considering whether non-creditors contribute to the going concern value, they ignore the ex ante effect of insolvency law completely. Such protection of jobs and community is at a huge cost, due to uncertainty caused by such practice. Insolvency

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104 Mark J. Roe and Frederick Tung Breaking Bankruptcy Priority: How Rent-Seeking Upends the Creditors’ Bargain (2013) 99 Virginia Law Review 1236 p1245; For example, according to chapter 11U.S. Code § 503 allows certain post-petition claims to obtain administrative expense priority, includes ‘wages, salaries, and commissions for services rendered after the commencement of the case’ as a way to encourage these key parties to support the operation of business. 11 U.S. Code § 503 - Allowance of administrative expenses
105 From the traditionalists’ point of view, rehabilitation function of insolvency law plays an important and independent role. Redistribution is used to balance the conflicting interests of all the stakeholders; this is a tough job equal to selecting values worth protecting. Elizabeth Warren ‘Bankruptcy Policy’ 54 U. Chi. L. Rev. 775 (1987) p786; Donald R. Korobkin ‘Rehabilitating Values: A Jurisprudence of Bankruptcy’ (1991) Columbia Law Review, Vol. 91, No. 4, p773
106 When insolvency laws try to rescue an economically inefficient company for the community, the creditors’ interests will be harmed. The reason is creditors have to keeping support the distressed companies alive even if the further operating of it will incur loss. The redistribution from creditors to the ones who will benefit in the community will increase the uncertainty for the creditors. Even though the community may not suffer disturbance in short term, the rise of the cost of credit arising from the uncertainty will give rise to low economic activities which in turn lead to low investment and less jobs to the communities. Robert Rasmussen, David A. Skeel Jr. ‘The economic analysis of corporate bankruptcy law’ (1995) 3 Am. Bankr. Inst. L. Rev. 85 p87
law may protect these non-creditor stakeholders if doing so is necessary for insolvency law to function and can maximize the going concern value of the companies. In other words, protecting non-creditors in such a case is not only in line with creditors’ interests, but it also causes the smallest alteration of non-insolvency law rights. By adopting the insolvency proceedings, every party will have a larger piece of the pie to share. Such added value derives from going concern surplus of the aggregate assets. Also, insolvency law replaces the first come, first served danger of a world without bankruptcy law, so it saves monitoring costs of the debtors’ assets and guarantees the same portion of assets for the creditors who are similarly situated.

Also, one needs to be aware that non-insolvency law does not prescribe how to resolve collective issues faced by insolvency law. Issues regarding how to offer protection to different stakeholders and how to distribute assets are of a collective nature which cannot be answered by non-insolvency law envisaged by the economic account’s scholars. Arguably, general laws are ill-equipped to deal with bankruptcy issues due to their collective nature; bankruptcy law is better positioned to tackle these issues. Insolvency law should deal with the disputes in a collective way; otherwise, bankruptcy courts cannot obtain the necessary information regarding whether it is correct to save the business, as creditors go to different courts to resolve their general disputes. The insolvency of

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108 An example would be the 'stay' mechanism under the insolvency law, which binds all the creditors from destroying the intact value of insolvency assets. Douglas G. Baird & Thomas H. Jackson, 'Corporate Reorganizations and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy,' (1984) 51 University of Chicago Law Review 97, p101
110 As a result, bankruptcy law effective constrains the self-interest of individual by forcing them to obey to collective and compulsive insolvency proceeding so as to achieve a better result. Thomas H. Jackson, The logic and limits of bankruptcy law (Harvard university press 1986) p15
112 Nicholas L. Georgakopoulos, 'Bankruptcy law for productivity' (2002) 37 Wake Forest L. Rev. 51 p92
113 For example, tort law may offer victims entitlement to compensation, however, such rules does not indicate how much compensation a victim could expect when the company is insolvent. To regulate such issue, tort law has to create a new section titled compensation where debtor is insolvent. As a result, such
debtor influences all the creditors together, so only insolvency law can collectively repay
the debtors and make wise decisions on behalf of all creditors.

Therefore, insolvency mechanisms need to supplement non-insolvency laws in this
regard.114 For example, stay can be viewed as supplementary to non-insolvency law rather
than purely aiming to alter the non-insolvency entitlements of creditors.115 The priority of
stakeholders is supplemented to non-insolvency law to arrange redistribution of value in a
collective way.116

The economic account is correct to value the ex ante influence while it ignores the fact
that business may not be able to be sold straight away on the market.117 The reality is that
the insolvency law market may sometimes be very thin such that buyers are difficult to be
found, especially for large companies. Even though the companies could be sold at a good
price, the sale may take a couple of months due to certain market failures. For example,
potential buyers may hesitate to buy as they lack information regarding the value
distressed business. This indicates that the business still needs to be run so as to keep the
business alive as a going concern. Without the ability to pay certain employees and
suppliers during reorganization, going concern value made up by these parties will

insolvency section could also be seen as part of insolvency substantive law. It does not make too much
difference to put such insolvency section of tort law under tort law or insolvency law.
114 Therefore, insolvency laws exist to fill in one special gap left by many non-bankruptcy laws in the sense
that insolvency law provides a collective solution to all the stakeholders whose rights are from non-
insolvency laws. For example, without insolvency law, the creditors may not have incentive to rescue a
business; debtors may distribute assets to third parties at undervalue price. G. Eric Brunstad, Jr.
55 Bus. Law. 499 p506; Charles W. Mooney, Jr., ‘A Normative Theory of Bankruptcy Law: Bankruptcy As
115 Charles W. Mooney, Jr., ‘A Normative Theory of Bankruptcy Law: Bankruptcy As (Is) Civil Procedure’
116 Without insolvency, for example, there is no need to promulgate rules to pay employees’ wages first.
Since the debtor company has ability to pay all its debt, everyone's payment will be honoured. Roy Goode,
117 Some may argue that liquidation is enough to preserve the going concern value of a distressed
business, as nothing stops liquidation to sell the business as a whole. However, this point of view can only
be true if the distressed companies could be sold at a fair market price straightaway.

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dramatically disappear. Insolvency law creates a correct incentive for creditors to preserve the going concern value of insolvent companies during the renegotiation of the reorganization plan.

The goals of corporate rescue law are preservation of going concern value and certainty. The two goals need to be balanced, as strict conformity of the certainty requirement will render insolvency law not able to preserve going concern value. A possible balance point could be found where non-insolvency law can only be altered in the insolvency proceedings for the purpose of preservation of going concern value. This can be seen as the supplementary tools provided by insolvency law to deal with specific collective insolvency issues.

2.2 The Implication of corporate rescue theories on MCGs and theories of MCGs

After arguing that the goals of corporate rescue law are the preservation of going concern value and certainty, this section will examine their implications to the cross-border insolvency of MCGs. The section will first examine the legal definition of MCGs. After concluding that control is the key factor used to define MCGs, the thesis moves to the task of examining the theoretical grounds of control and its relationship with the group going concern value. The discussion is conducted in the light of theories of MCGs. The Next section tries to explore the relationship between the formation of the group going concern value and the allocation of head office functions inside the MCGs. This not only provides a better understanding of group going concern value and MCGs, it also has implication to cross-border insolvency jurisdiction rule. Finally, the section examines

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118 This is the reason to have administration fee with priority and ability for insolvency practitioners to make direct payment as they think fit for the purpose of value preservation.
the implication of corporate rescue theories to the cross-border insolvency of MCGs, and provide an analysis for three main solutions that can preserve group going concern value.

2.2.1 Legal definition of MCGs

As the name indicates, MCGs are multinational corporate groups which carry out business in two or more countries. The member companies in a MCG may be situated in different EU member states and subject to different company laws and insolvency laws.

Multinational business can be done on a cross-border scale by many legal forms including companies, partnerships and non-equity based organizations such as franchise agreements. Nonetheless, in the current business world, most large firms adopt the form of groups of companies with different group structures. Among other things, a prevalent form is corporate groups formed by limited liability companies. Most large companies are MCGs, and they play a very important role in the EU. The reason to take corporate groups as the research focus is that the insolvency of large corporate groups has a far-reaching impact on the European economy. Large corporate groups yield 30% of jobs in the EU and produce 41% of gross added value. This thesis focuses on MCGs as the typical target to discuss cross-border insolvency issues.

To define such ‘group’, i.e. an internal environment, the general way is by means of

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121 Irit. Mevorach, Insolvency within multinational enterprise groups (OUP 2009) p20
122 Irit Mevorach, 'The Road to a Suitable and Comprehensive Global Approach to Insolvencies Within Multinational Corporate Groups' (2005) JPLP 15 5 p4
control which could be exerted by ownership and contracts. Ownership is one typical way to determine control. It is a way to define the boundary of a MNC, as it clearly shows that one subsidiary belongs to the group where the parent company owns majority of shares of it. There are many ways that one parent could own subsidiaries by either direct or indirect ownership. Even if in the case where the parent company does not directly own the subsidiary, it could still exert control on it.

Therefore, another line could be drawn by means of control. Control is a standard which makes it easy to differentiate two cases: shares held by the parent in subsidiaries as a means of transfer of resources or as a simple means of investment. In the corporate laws of many countries, once a parent company holds more than 51% shares of its subsidiaries, it can establish control over them by ownership. Sometimes, de jure control could be established by cross holdings whereby three companies mutually hold certain amount of each other's shares and agree to operate in uniform way. Another form-circular holding in a chain structure, allows the top parent to control the subsidiaries far away down the hierarchy of which the parent company owns less than 51 percent shares. For example, the parent company may able to directly control a subsidiary by owning a 51 percent shares of the latter, while it can also indirectly control the sub-subsidiary by owning less than a 51 percent of shares of it.

Control could also be obtained by means of contracts. In EU competition law, control is defined as: 'Means which confer the possibility of exercising decisive influence on an undertaking, in particular by rights or contracts which confer decisive influence on the

126Ibid p889
129Ibid p313
composition, voting or decisions of the organs of an undertaking.\textsuperscript{130}

Control could be used as a workable standard to the corporate groups, which assign obligations to parent companies.\textsuperscript{131} Also, the control of parent companies is sometimes expressed as the existence of the share ownership in subsidiaries and determination of board members of subsidiaries.\textsuperscript{132}

\textsuperscript{130} Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings (the EC Merger Regulation) Article 2(b)

\textsuperscript{131} See Examples could be found as follows:

1. UK company act 2006 provides straightforward definitions in terms of holding companies and subsidiaries as follows: ‘A company is a “subsidiary” of another company, its “holding company”, if that other company—(a) holds a majority of the voting rights in it, or (b) is a member of it and has the right to appoint or remove a majority of its board of directors, or (c) is a member of it and controls alone, pursuant to an agreement with other members, a majority of the voting rights in it, or if it is a subsidiary of a company that is itself a subsidiary of that other company. UK Companies Act, 2006, c. 46, § 1159(1); Harry Rajak, ‘Corporate group and cross border bankruptcy’ Texas international law journal vol 44 P530

2. In the area of accounting, the parent companies assume the obligation to prepare the group consolidated account. From the definition of Directive 2013/34/EU, ‘parent undertaking’ means an undertaking which controls one or more subsidiary undertakings; ‘subsidiary undertaking’ means an undertaking controlled by a parent undertaking, including any subsidiary undertaking of an ultimate parent undertaking; ‘group’ means a parent undertaking and all its subsidiary undertakings; ‘associated undertaking’ means an undertaking in which another undertaking has a participating interest, and over whose operating and financial policies that other undertaking exercises significant influence. An undertaking is presumed to exercise a significant influence over another undertaking where it has 20 % or more of the shareholder members’ voting rights in that other undertaking’ see Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC art.2 (9-13) The rules also consider the size of the corporate group in terms of their balance sheet total, net turnover and numbers of employees by classify three types of groups with different rules: Small undertakings medium sized undertakings and large size groups, see art 3 of Directive 2006/43/EC.

3. In the tax areas, the corporate groups are allowed to benefit from group relief provisions so as to reduce the tax burden. The main idea of such mechanism is to allow corporation tax losses members (surrendering companies) to transfer such losses to profit-making members (claimant companies) so as to set-off the tax liabilities of the latter. Peter T. Muchlinski, Multinational enterprise and the law 2 edition OUP 2007 P265 Taking UK corporation tax act as an example, the surrendering company and the claimant company should be form a group and both UK-related. Art.152 provides definition of groups of companies as: ‘For the purposes of this Part two companies are members of the same group of companies if—

(a) one is the 75% subsidiary of the other; or .

(b) both are 75% subsidiaries of a third company’. see Corporation Tax Act 2010 Part 5 group relief chapter 1 section 152. Both directly or indirect ownership are permissible. see Group relief visited 21/09/2014 http://www.out-law.com/en/topics/tax/corporate-tax/group-relief/

Also the OECD tax model Art. 9 which deals with tax liabilities of profits adjustment of group members provides definition of corporate groups: an associated enterprise is an enterprise ‘where an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State’ OECD Model Convention with respect to taxes on income and on capital article 9.

Even though MCGs are the prevalent form of doing business in a cross-border context, the specific legal regimes to deal with corporate groups are rare. Unlike the corporation as a well-developed concept which underlies the world legal system, MCGs in many areas of law are seen not as whole entities, but as a group of individual companies in law. In certain areas of law, the MCGs have been treated as an economic integration, while the issues of limited liabilities of individual companies are respected. The exemplary areas are accounting and tax areas.

In the area of cross-border insolvency law, legislations for MCGs are rare. However, there is a new development in the area of cross-border insolvency law. The newly released EU regulation on insolvency proceedings recast provides a definition for groups of companies which corresponds the Accounting Directive 2013/34/EU above. Its definition is as follows:

‘(13) ´group of companies´ means a parent undertaking and all its subsidiary undertakings; (14) ´parent undertaking´ means an undertaking which controls, either directly or indirectly, one or more subsidiary undertakings. An undertaking which prepares consolidated financial statements in accordance with Directive 2013/34/EU of the European Parliament and of the Council (1) shall be deemed to be a parent undertaking’.  

From the EIR recast, one can see that control is the key factor to define MCGs. Definitions could be provided by a certain percentage of shareholdings or votes either directly or indirectly; or a functional means of control either formed by ownership or contracts (de facto). The essence is that control links member companies in MCGs.

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133 Eva M.F. de Vette, ‘Multinational enterprise groups in insolvency: how should the European Union act?’ (2011) Utrechtlawreview.org Volume 7 (1) p1
134 UNCITRAL Legislative Guide on Insolvency Law—Part three p14
135 EIR recast 2015 Art. 2
136 UNCITRAL Legislative Guide on Insolvency Law—Part three p15
2.2.2. Theoretical grounds of control and the group going concern value of MCGs

As above-mentioned, control is the key factor to define MCGs in many areas of law. One may ask why 'control' is the reasonable test to draw the line of MCGs. To examine the control test, it is helpful to consider why MCGs exist in the first place.

One explanation of the raison d'être of traditional hierarchical MCGs is that internalization of certain activities inside the MCGs reduces costs that would otherwise arise in arm's length transaction in the market. In other words, the imperfection of markets causes MCGs to locate some of the business activities inside a group whereby the transaction cost could be reduced.\(^{137}\) Internalization theory\(^{138}\) provides useful insights to explain the boundaries of MCGs. The relationships among group members are different to and superior to arm's length market relationships. Nonetheless the cost of setting up foreign subsidiaries is high, compared to licensing agents or forming alliances in foreign countries or exporting products, the corporate groups still choose to do so as the benefit of such relationships outweigh the cost.\(^{139}\)

To understand how the transaction cost could be reduced, it is useful to recall resource-based theory, knowledge-based theory as previously discussed. Resource-based theory provides that in order to succeed in the market, companies should possess rare valuable non-substitutable and inimitable resources to gain advantages.\(^{140}\) These valuable resources


\(^{140}\)Examples of valued resources and capabilities include reputation, buyer-supplier relationships, tacit knowledge, R&D expertise, and technological capabilities. Jay Barney, 'Firm resources and sustained
not only include valuable physical assets, but also include the knowledge regarding the use of these resources and regarding learning and accumulating knowledge and external opportunities. Besides other resources, the knowledge possessed by groups of companies are invaluable and the key for groups of companies is to transfer and coordinate the knowledge to produce advantages.

The transfer of knowledge to foreign agents may contain transaction costs. Transaction costs deriving from unbounded rationality and opportunism make the contracts of knowledge transfer costly. For example, licensees have the incentive to make sure of what they are buying, while the seller company has an incentive to conceal information in the fear that licensees can learn them and compete with the company later. The information cost and bargain cost will rise as a result. In terms of vertical integrated business where the intermediate product of one company is the raw material of another, the possibility of withdrawal of any party from the cooperation will cause uncertainty. Contracting with new suppliers or customers requires original parties to acquire new information and adapt to new requirements. The costs of uncertainty and contracting may be huge.

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143 The difficulty to absorb and understand complicated information.

144 The contractual parties may pursue self-interest.


147 ibid p32
By contrast, if the licensees are replaced by internal subsidiaries, the group may send employees who master the relevant knowledge to educate subsidiaries at low cost and the group does not need to worry about knowledge leakage.\textsuperscript{148} The bargaining cost and information cost of relevant contracts will be lower. Theoretically, the boundaries of an MCG lies in the place where the benefits of further internalization of markets equals the costs.\textsuperscript{149} Therefore, for the purpose of internalization and reduction of transaction cost, it may be necessary for groups to be able to control their advantageous resources.\textsuperscript{150} This demand justifies the control test.

MCGs will expand their business to other countries if they can gain more net benefits from managing the interdependent relationships between different subsidiaries than can the market.\textsuperscript{151} The above analysis shows that the relationships of group member companies in an MCG may be of great value. This is more likely to be true if the member companies are functionally connected with each other. This possibility is supported by resource-based theory, knowledge-based theory, as they also indicate that relationships are valuable resources. MCGs need competitive advantages such as innovations to stay successful in the market. Nowadays, many important innovations are achieved at the subsidiaries’ levels, so that subsidiaries are strategic resources of the MCGs.\textsuperscript{152} As it is not enough to perform better than rivals in the global market solely relying on the strength of the parent company, all the subsidiaries should contribute their knowledge learnt from the local environment to the MCGs.\textsuperscript{153}

\textsuperscript{149} Peter j Buckley, Mark c casson, ‘The internalization theory of the multinational enterprise: a review of progress of a research agenda after 30 years' (2009) Journal of International Business Studies  40 p1564
\textsuperscript{151} Jean-Francois Hennart ‘Theories of the multinational enterprise’ in Alan M. Rugman, The Oxford handbook of international business (2nd Edition OUP 2009) p133
\textsuperscript{152} Francesco Ciabuschi, Ulf Holm, Oscar Martin Martin ‘Dual embeddedness, influence and performance of innovating subsidiaries in the multinational corporation’ (2014) International Business Review 23 p897
\textsuperscript{153} Yves DOZ, Jose F.P. & Santos ‘ On the management of knowledge: from the transparency of collocation and co-setting to the quandary of dispersion and differentiation' INSEAD, Fontainebleau, France p6
Foreign subsidiaries have better access to the information and country-specific advantages, such as technology and low cost of labour. The business relationships allow other group members to understand the foreign environment and demand, and learn and share with each other. The group can locate subsidiaries to gain local advantage and transform the country-related advantages into firm-specific advantages, and transfer them to other subsidiaries. Networks may form relational economic rents which cannot be gained by the regular market relationships. Such relationships do not contain idiosyncrasies by which the parties can gain advantage over rivals. Business relationships are the pipes of information, resources, technologies and marketing between member companies, and they could be seen as important intangible resources of companies.

Therefore, group members which are in powerful networks may be in an advantageous position over their rivals. Single company's competition becomes networks' competition. This reality provides us with a business network perspective which shows that the companies in networks do not necessarily get the ownership of the resources as long as they have access to the service generated from the resources of other parties.

Subsidiaries not only contribute value but also receive the benefits from other member

154 Francesco Ciabuschi, Ulf Holm and Oscar Martin Martin 'Dual embeddedness, influence and performance of innovating subsidiaries in the multinational corporation'(2014) International Business Review 23 p905
155 Ulf Andersson, Henrik Dellestrand, Torben Pedersen, 'The Contribution of local environments to competence creation in multinational enterprises' Long Range Planning 47 (2014) p95
157 Mats Forsgren, Theories of the multinational firm, (second edition, Edward Elgar publishing limited UK 2013)p108
companies across distance and countries.\textsuperscript{160}

The internalization theory and resource-based theory may therefore indicate that it is possible for certain MCGs to have group going concern value among their relationships\textsuperscript{161} which is worth preserving for the purpose of insolvency law. Without corporate group insolvency rules, the mutual adaptation networks of business could break down in pieces and relational rent will be lost.\textsuperscript{162} It may be the case that certain companies cannot be rescued without putting them back into the network to cooperate with other member companies. This possibility has been recognised by the European Commission, which believes that an insolvent subsidiary may itself not be viable without the support of the rest of the members of group.\textsuperscript{163} Without a group solution, the value of groups dissipates significantly.

2.2.3. Group going concern value and the allocation of head office functions in MCGs

The last section reveals that MCGs may internalize market relationships for the purpose of the group going concern value. The internalization is reflected by the control linking group member companies together. However, it does not indicate how the control is allocated inside an MCG among its subsidiaries in different member states. This question is important, as even if one parent company can control its subsidiaries, it may not do so

\textsuperscript{160}Ulf Andersson and others, 'The Contribution of local environments to competence creation in multinational enterprises' (2014) Long Range Planning 47 p96
\textsuperscript{161}The key resources could be network itself. It could be the case that two companies combine their resources together in a unique way, thereby they gain competitive advantages over other companies, which can be achieved by means of such combination. Jeffrey H. Dyer and Harbir Singh, The Relational View: cooperative strategy and sources of Inter-organizational competitive advantage' (1998) The Academy of Management Review, Vol. 23, No. 4 p661; Ranjay Gulati and others, 'Strategic networks' (2000) Strat. Mgmt. J. 21 203–215 p207
\textsuperscript{162}In an extreme case, it is even possible for one subsidiary to lose all the going concern value if its network is cut off. For example, if one factory lose important IP licence, the remaining assets may have no going concern value higher than liquidation value.
in reality.\textsuperscript{164} It is possible for the parent company to give up control and allocate certain head office functions to the foreign subsidiaries for the purpose of the group going concern value. Therefore, the analysis of this question will provide a better understanding of the relationship between the formation of group going concern value and allocation of head office functions in MCGs. More importantly, the allocation of head office functions has impact on insolvency jurisdiction rules which allocate jurisdiction to the court where the head office functions of one company are carried out.\textsuperscript{165} This section will focus on the discussion of the relationship between group going concern value and the allocation of head office functions within MCGs.

The last section has shown that group members in MCGs may rely on each other's advantages and resources. It is true that companies are open systems as they interact with the outside environment in certain ways.\textsuperscript{166} The multinational corporate groups attract resources from foreign countries and coordinate between member companies internally in an efficient way, which in return allows them to generate huge profits.\textsuperscript{167} In order to make products or service competitive, the value that one product or service could generate should be higher than average level.\textsuperscript{168} Resources themselves do not automatically generate value, whereas the value is wielded by means of unique combinations of resources and capacities. For the purpose of creating value, MCGs have to combine their

\begin{itemize}
  \item [164] Mats Forsgren and others, \textit{Managing the embedded multinational--a business network view}, (Edward Elgar, Cheltenham UK 2006) p93
  \item [165] Whether the parent company can be viewed as the only character which executes the head office functions determines the certainty of rules for procedural consolidation. See Chapter 3
  \item [166] Mats Forsgren and others, \textit{managing the embedded multinational--a business network view}, (Edward Elgar, cheltenham UK 2006) p92
  \item [167] ibid p1
  \item [168] Value is gauged by the performance attributes of products to the customers who would like to purchase them. Resources could include financial resources organizational resources(coordinating system) physical resources and technological resources, or intangible resources such as knowledge capacities to innovate, goodwill.' see R. Duane Ireland et al \textit{The management of strategies concept and cases} (9\textsuperscript{th} International Edition South-western Cengage Learning 2010) P66
\end{itemize}
resources\textsuperscript{169} and capacities\textsuperscript{170} in a unique way which may require certain cooperation between member companies.

For this purpose, group members need to form close relationship whereby they can facilitate the formation and digestion of knowledge gained by subsidiaries from the external environment.\textsuperscript{171} The complicated and dynamic foreign environment of subsidiaries lead to information asymmetry, which forces parent companies to rely on subsidiaries for the purpose of information understanding and decision making, no matter what corporate structure the MNC adopts.\textsuperscript{172} The value subsidiaries can generate and the information asymmetry together make group members interdependent.\textsuperscript{173} Attention should be paid that such interdependent relationships are distinguished from market relationships that do not yield going concern value.\textsuperscript{174}

The interdependent relationships generally are formed over a long time.\textsuperscript{175} The network reflecting the interdependence is difficult to be replaced by a third party, at least in a short time, as they face difficulties in understanding the unique nature of relationships of the previous party with regard to the interdependence, know-how and technologies.\textsuperscript{176} This is

\textsuperscript{169}‘Capacities exist when resources have been purposely integrated to achieve a specific task or set of tasks, such as develop and transfer knowledge.’ R. Duane Ireland and others, \textit{The management of strategies concept and cases} (9th International Edition South-western Cengage Learning 2010) p70

\textsuperscript{170}Advantages gained from preceding combination conferring core competences to the corporate group, such as Amazon combines its service and distribution resources. R. Duane Ireland and others, \textit{The management of strategies concept and cases} (9th International Edition South-western Cengage Learning 2010) p72

\textsuperscript{171}Francesco Ciabuschi, Ulf Holm, Oscar Martin Martin 'Dual embeddedness, influence and performance of innovating subsidiaries in the multinational corporation' (2014) International Business Review 23 p906

\textsuperscript{172}Francesco Ciabuschi, Henrik Dellestrand, Ulf Holm 'The role of headquarters in the contemporary MNC' (2012) Journal of International Management 18 p218

\textsuperscript{173}Thompson JD. \textit{Organizations in action}. (New York McGraw-Hill 1967)

\textsuperscript{174}Interdependence may exist in many forms such as sequential interdependence where one company need the input of other companies and reciprocal interdependence where such sequential input is multi-sided. Jeffrey H. Dyer and Harbir Singh, 'The Relational View: Cooperative Strategy and Sources of Inter-organizational Competitive Advantage' (1998) The Academy of Management Review, Vol. 23 (4) p 662

\textsuperscript{175}From a study by Hakansson 1982, the average age of business relationship is more than 15 years. Hakansson, H. \textit{International marketing and purchasing of industrial goods. An interaction approach}. (John Wiley &sons 1982)

\textsuperscript{176}Mats Forsgren, \textit{Theories of the multinational firm},(second edition, Edward Elgar publishing limited UK 2013) p108
especially true in the MCGs context where the network is multi-dimensional involving multiple-parties.\(^{177}\) Relying solely on the advantages of parent companies is inadequate for MCGs to outperform competitors unless they are the only holders of certain resources; they have to explore and integrate as broad as possible country-specific advantages so as to enhance their competence.\(^{178}\) So, one important job that every head office has to do is to transfer the useful knowledge gained from the local subsidiaries to other group members.\(^{179}\) As a result, the parent company may rely on the contribution such as technologies from subsidiaries.\(^{180}\)

More importantly, from the resource dependence theory, the dependence can create power and control.\(^{181}\) Even though parent companies have power over subsidiaries through its authority, they may be unable to exert it in some aspects. The reason is that subsidiaries and parents may be interdependent to each other which prevent parent companies from exerting full control on the subsidiaries.\(^{182}\)

The dynamics of relationships and control between group members have been recognized

\(^{177}\)Håkan Håkansson and Ivan Snehota, Developing Relationships in Business Networks, (Routledge London 1995) p139

\(^{178}\) Yves DOZ, Jose F.P. & Santos, 'On the management of knowledge: from the transparency of collocation and co-setting to the quandary of dispersion and differentiation' INSEAD, Fontainebleau, France, p6


by scholars embracing a business network perspective on MCGs.\textsuperscript{183} As opposed to the traditional view considering MCGs as hierarchies,\textsuperscript{184} the business network perspective believes most of the organizations can be seen as bundles of different networks.\textsuperscript{185} In reality, relationships of multinational companies may be more similar to differentiated networks than hierarchies. Regarding the task of governing multinational subsidiaries, it is beyond the capacities of any homogeneous organizational structures to capture and respond to the characteristics of MCGs with subsidiaries operating under various environments.\textsuperscript{186} Every subsidiary should retain some degree of autonomy to cope with the complex local environment.

Besides the value gained from foreign locations or countries, the new roles that subsidiaries take also partly explain why parent companies in modern MCGs are likely relying on subsidiaries. Subsidiaries more and more take on innovation and research roles as opposed to the implementer roles which only enforce the mandate from parent companies in traditional hierarchical structures.\textsuperscript{187}

\textsuperscript{183}Mats Forsgren, *Theories of the multinational firm*, (Second edition, Edward Elgar publishing limited UK 2013) p107

\textsuperscript{184}Following this assumption, a group is called hierarchically centralised group when parent companies may make all the decisions on behalf of its subsidiaries. Also, if the business of group members are interdependent, the group can be called business integrated group. Centralization and integration can be seen as two variables of headquarter and subsidiaries relationships. Julian M. Birkinshaw and Allen J. Morrison, 'Configurations of Strategy and Structure in Subsidiaries of Multinational Corporations' (1995) Journal of International Business Studies, Vol. 26, No. 4, p732; Stephen R. Gates and William G. Egelhoff, 'Centralization in Headquarters-Subsidiary Relationships' (1986) Journal of International Business Studies, Vol. 17(2) p72


Furthermore, a good local research environment endows the subsidiaries considerable potential to take on creative roles especially in the cases where the subsidiaries' functional mandates are broader; long-term development makes them able to transform from the home-country's implementer to a globally integrated creator.\textsuperscript{188}

To imagine one corporate group as a simple hierarchy where the parent controls all foreign subsidiaries in the same way does not reflect the reality of how a group is organized.\textsuperscript{189} Even though the parent company enjoys the authority as a result of its top position in the hierarchy, it rarely controls all the subsidiaries in the same way. Some of them in fact enjoy considerable autonomy in some aspects of decision-making.\textsuperscript{190}

Research has shown that both European and UK MCGs are inclined to decentralize as their foreign subsidiaries' sizes grow. For example, UK corporate groups are prone to delegating power of marketing and manufacturing to local subsidiaries while retaining the financial decision-making power.\textsuperscript{191} The subsidiary is both embedded\textsuperscript{192} in the internal and external networks containing unique features and roles to contribute to the group, and retaining a certain level of autonomy in some aspects that they have expertise and resources.\textsuperscript{193} The new roles that subsidiaries play and the complex environments that these

\textsuperscript{189}Nitin Nohria, Sumantra Ghoshal, \textit{The differentiated network} (Jossey-Bass Inc. San Francisco 1997) P4
\textsuperscript{190}ibid P14
\textsuperscript{192}Subsidiaries embeddedness is meant that subsidiaries form long term business relationship from which they adapt to each other in terms of production process; the benefit is that learning from these parties could contribute innovation so that valuable knowledge and technology could be transferred to other parties of group members which enhance the competence of the whole MNC. See Mo Yamin, Ulf Andersson 'Subsidiary importance in the MNC: What role does internal embeddedness play?' (2011) International Business Review 20 p152
\textsuperscript{193}Andersson, U., Forsgren M. 'In search of centre of excellence: network embeddedness and subsidiary roles in multinational corporations.' Management International Review 40, p332, see also Eva A. Alfoldi et al, ‘Coordination at the Edge of the Empire: The Delegation of Headquarters Functions through Regional Management Mandates’ (2012) Journal of International Management 18 p276
subsidiaries need to confront help subsidiaries gain power from parent company. Where the subsidiaries have expertise in certain areas such as R&D, they may form subsidiaries’ specific advantages which could be used uniquely in their local market; the advantages can even be spread out to the whole group, which are called non-location-bound company’s specific advantages. The transfer frequency of knowledge from top to bottom and from subsidiary to subsidiary are the same, which indicates that structures of MCGs are better described as networks than hierarchical as they may directly share knowledge with other sister subsidiaries rather than via a joint head office of MCGs.

One can therefore argued that head office functions are increasingly allocated to different levels in MCGs according to strategic demand; some head office functions may be at the level of subsidiaries, while others may be at the level of regional head-quarters. It could be divided into multi-divisions according to the functions, regions and business which can exist in the same group. Therefore, the place of the nominal head office does not indicate that all the head office functions are there. It cannot be assumed that the head office functions always stay in one place, such as the home countries of the ultimate parent in MCGs. Research has shown that with the growth of MCGs, parts of the head office functions such as management teams and staff functions may be moved overseas.

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196 ‘Head office’ is a term generally describing an organization that is responsible for the long-term strategies of a company.
199 ibid P216; see also Henrik Dellestrand, ‘Subsidiary embeddedness as a determinant of divisional headquarters involvement in innovation transfer processes’ (2011) Journal of International Management 17 p237
for demand purposes such as better serving the stakeholders.\textsuperscript{201}

While parent companies may frequently arrange financing on behalf of MCGs, the contributions from other group members with reference to value creation are no less important than that of financing.\textsuperscript{202} In fact, it has been argued that technological resources can generate the highest level of power over other aspects of resources such as financial capital resources or distribution capacities.\textsuperscript{203} Research has been done to show that strategic power which could influence the whole group is gained by subsidiaries which are in charge of technology-related functions.\textsuperscript{204}

Therefore, the decentralization and centralization of control are two extreme ends of the spectrum of how MCGs exert control and allocate head office functions, while the reality is somewhere in the middle.\textsuperscript{205} The hierarchical structure is only applicable to cases where the environment of a subsidiary is not complex and the subsidiary does not control important resources.\textsuperscript{206}

However, this does not mean that parent companies do not carry out any head office functions.\textsuperscript{207} Parent companies are more likely to perform parts of the functions while they delegate the rest of head office functions to subsidiaries. The need to balance the corporate group interest and local responsiveness requires the large companies to adjust

\textsuperscript{201}ibid p46, p49
\textsuperscript{203}Ram Mudambi et al ‘How subsidiaries gain power in multinational corporations’ (2014) Journal of World Business 49 p103
\textsuperscript{204}Examples of technology-related functions are research and development; examples of business-related functions are marketing and distribution. ibid p109
\textsuperscript{205}Ambos, B., Schlegelmilch, B.B. The New Role of Regional Management. (PalgraveMcMillan.2010) p1
\textsuperscript{206}Nitin Nohria, Sumantra Ghoshal, The differentiated network (Jossey-Bass Inc. San Francisco 1997) p111
their head office functions vis-a-vis every subsidiary.\textsuperscript{208} To contribute to and control the local subsidiaries, the pre-condition is that head office should understand local business and also have capacity to provide support to local subsidiaries.\textsuperscript{209} This will help the MCGs to adapt to an ever-changing environment and allow them to balance local responsiveness and integration.\textsuperscript{210}

The head offices of corporate groups also need to adjust the proportion of power they delegate to the different subsidiaries. Even parent companies enjoy authority to make decisions superseding the subsidiaries’ ones, they may not do so as it is too costly to make mistakes.\textsuperscript{211} Parent companies cannot fully control the subsidiaries, nor can they fully set subsidiaries free as it may conflict with the long-term strategic plan of the group.\textsuperscript{212}

From the above discussion, a conclusion could be drawn that the resources that foreign subsidiaries can obtain and the new roles that they play make foreign subsidiaries valuable for the MCGs. The network among member companies forms group going concern value as it provides the capacities to the MCGs to transfer these resources to other members of MCGs. As a result, complex environment of subsidiaries\textsuperscript{213} and the interdependence\textsuperscript{214} between member companies require MCGs to adopt flexible control and structures as opposed to rigid hierarchies. In the case where the subsidiaries control important resources, the subsidiaries gain more bargaining power over other companies in

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{208}Björn Ambos, Volker Mahnke 'How Do MNC Headquarters Add Value?' (2010) Management Int. Rev 50 p404
\item \textsuperscript{209}ibid p405
\item \textsuperscript{210}Kirsten Foss et al 'MNC Organisational form and subsidiary motivation problems: controlling intervention hazards in the network MNC' (2011) available at: http://ssrn.com/abstract=1969402 p6
\item \textsuperscript{211}Kirsten Foss, Nicholai J Foss, 'Resources and transaction costs: How property rights economics furthers the resource based view' (2005) Strat. Mgmt. J., 26: 541–553 p544
\item \textsuperscript{212}Nitin Nohria and Sumantra Ghoshal, 'Differentiated Fit and Shared Values: Alternatives for Managing Headquarters-Subsidiary Relations' (1994) Strategic Management Journal, Vol. 15, No. 6 p492
\item \textsuperscript{213}Ulf Andersson and Mats Forsgren, 'In Search of Centre of Excellence: Network Embeddedness and Subsidiary Roles in Multinational Corporations' (2000) Management International Review, Vol. 40, No. 4 p344
\item \textsuperscript{214}Mohan Subramaniam, Sharon Watson 'How interdependence affects subsidiary performance' (2006) Journal of Business Research 59 p918
\end{itemize}
\end{footnotesize}
Therefore, the head office functions of MCGs are frequently allocated to foreign subsidiaries for the purpose of obtaining group going concern value. This is the relationship between the formation of group going concern value and the allocation of head office functions in MCGs. Its implication is that one may not be able to identify the location where the head office functions of an MCG are carried out. This may have an implication on cross border insolvency jurisdiction rules.

2.2.4. Implication on the treatment of MCGs in cross border insolvency context

A company has independent legal status; the limited liability and legal personality are core features of companies which generate economic efficiency by lowering the cost of doing business. For instance, by enabling companies to own properties, shares can be transferred easily from sellers to buyers without costs arising from transfer of business; limited liabilities of investors also encourage businessmen to engage in their business activities. The merits and legal endowment of legal personality and limited liabilities are widely respected and applied. It is possible in certain areas of law, such as accounting rules(consolidated account), to design certain rules for groups of companies as a unit due to their economic integration, if the issue of protection of limited liabilities does not arise. However, in the field of insolvency law, considering the group as one unit may be impossible, as different companies in the group may have different profiles of creditors and respective assets. The limited liability of a company is the protection shield for stakeholders of different subsidiaries. Creditors in one subsidiary generally do not need to monitor the assets and other creditors' behaviour of another company in the group, as the creditors calculate risks only against the company to which they lend money. So it may be

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216 Irit Mevorach, *Insolvency within multinational enterprise groups* (OUP 2009) p41
217 ibid p41
218 ibid p52
radical to replace entity law with enterprise law in the context of insolvency of MCGs. Such a move may cause serious conflicts among different national laws in this regard.219

Another point worth mentioning is that corporate rescue law is in reality complex and elastic;220 different member states have different insolvency laws and may pursue similar but different goals. For example, whereas German insolvency law may focus more on debt collection, French insolvency law focuses more on social goals such as employment protection; UK and US insolvency laws are positioned somewhere in between.221 The same creditors in different member states may be treated differently. Corporate rescue theories need not conform to or explain every detail of national corporate rescue law; rather, the discussion of relevant theories only aims to find out what are desirable values that corporate rescue law in general should embrace.222

After acknowledging these facts, we can consider the implication of corporate rescue theories and multinational enterprise theories on the solutions of cross-border insolvency of MCGs. In the cases where the MCGs have group going concern value, it is desirable to preserve this value for the purpose of corporate rescue law. According to the above sections, the goal-preserving going concern value-of corporate rescue law indicates that it is desirable to have a group-wide solution in cross-border insolvency context.

On the other hand, the goal of certainty of corporate rescue law requires relevant methods to respect the independent legal personality of subsidiaries and the insolvency jurisdiction of each subsidiary; both affect creditors' rights in cross-border insolvency. Therefore, the desirable solutions should be able to preserve the value of MCGs in an

effective and predictable way. 

Generally speaking, there are four ways to deal with cross-border insolvency of groups of companies. They are substantive consolidation, procedural consolidation, market/hybrid legal solutions and cooperation/coordination. The common ground is that all these solutions have potentials to provide solutions to preserve group going concern value.

Substantive consolidation views all the member companies in the group as if they were one company. It aims to distribute the total assets of the group to all the creditors under one set of priority rules. Substantive consolidation is a method mainly used by the US courts to pull the assets and liabilities of companies together for the purpose of insolvency. Even in US case law, the conditions for using substantive consolidation is not clear. It is only applied in extreme cases. Examples include where one subsidiary’s veil needs to be lifted or where the assets of one corporate group are extremely mixed together which makes it costly to divide them into respective companies.

The UK court may show reluctance to apply substantive consolidation. In a UK case of Re Polly Peck international plc, where the administrator requested substantive consolidation, and the UK court denied the argument that one SPV subsidiary is just the façade of the given company and thereby they should be substantively consolidated. The UK court insisted that to use SPV solely for the purpose of finance is just a common commercial use of a corporate group structure, even if creditors are harmed. There is no

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225 ibid p21
226 Polly Peck International Plc (In Administration) (No.4), Re [1996] 1 B.C.L.C. 428
227 Simon Bowmer, ‘To pierce or not to pierce the corporate veil- why substantive consolidation is not an issue under English law’(2000) Journal of international banking law p6
necessity to transplant the concept of substantive consolidation to UK case law.\textsuperscript{228}

In Europe, such a concept may be subject to different interpretations by various member states and therefore it could be difficult to reach consensus regarding its use. Also, substantive consolidating companies located in different member states into one country will dramatically change the applicable insolvency law, which may not be expected by the local creditors.\textsuperscript{229} The best example is the different priority rankings of creditors in different member states' insolvency law. One creditor may be in the top ranking under local insolvency law, while he may be demoted to the second or even lower ranking under another country’s insolvency law. Transaction avoidance rule is also a good example to illustrate the risk issue. One conduct may be avoidable under one country’s law, while it is not avoidable under another’s. The size of each debtor’s assets is also different, so the result of substantive consolidation will benefit some general creditors at the expense of others.

In a typical cross-border insolvency case involving groups of companies, the issue is not whether the veil of subsidiary should be lifted or whether one should pull the assets of the group together due to the liability of parent company; rather, the issue is how to preserve the going concern value in a predictable way. Therefore, the substantive consolidation is not the means urgently needed to deal with cross-border insolvency challenges. More importantly, reconnecting group members together does not necessarily require treating the group as one company; for instance, procedural consolidation and cooperation mechanisms-may be more frequently used to achieve efficient insolvency results for MCGs.\textsuperscript{230} Therefore, the thesis will exclude substantive consolidation as the desirable option for cross-border insolvency of MCGs.

\textsuperscript{228} ibid p8
\textsuperscript{229} Robert van Galen, ‘Insolvent groups of companies in cross border cases and rescue plan’ (2012) p32
\textsuperscript{230} Irit Mevorach, ‘The "home country" of a multinational enterprise group facing insolvency’ (2008) International & Comparative Law Quarterly p1
Procedural consolidation aims to use cross border insolvency jurisdiction rules as solutions to preserve group going concern value. It tries to allocate the insolvency proceedings of group members into one court or as small a number of courts as possible. In terms of procedural consolidation, Professor Mevorach pointed out that the degree of integration and interdependence of group members seems to be very relevant in this regard.\(^\text{231}\) She believed that in the groups of companies where one company's tasks closely relate to others, connecting them together by procedural consolidation may be desirable.\(^\text{232}\) As a result, all the entities in the same group coming to one court to open insolvency proceeding may be beneficial, as all members could be subject to the same administration and to a large extent it helps preserve the value of the corporate groups.\(^\text{233}\)

However, the certainty requirement indicates that rules as such should be predictable so that the creditors can assess risks and benefits \textit{ex ante}. Preservation of value should not trump the important goal of certainty. Even though the merit of procedural consolidation regarding preservation of value can be appreciated, one still needs to examine whether such a rule is predictable. One gap left here is whether based on the current insolvency jurisdiction rule and features of MCGs, the groups of companies could be procedurally consolidated in front of one court in a predictable way.\(^\text{234}\) The danger is that pulling subsidiaries in front of one court and subjecting them to one national insolvency law may change many creditors' expectations. Therefore, one should be cautious to design conditions for procedural consolidation such that these rules have as little impact on creditors' expectations as possible. Procedural consolidation will be examined in Chapter 3.

\(^{231}\)She argued the integration is referred to as the degree that the member companies work together as a joint business, while the interdependence means that reliance of one member to the other members. Irit Mevorach, \textit{Insolvency within multinational enterprise groups} (OUP 2009) p131

\(^{232}\)ibid p157

\(^{233}\)ibid p157

\(^{234}\)The insolvency jurisdiction rule- the centre of main interest, will be examined in detail in Chapter 3.
Market/hybrid legal solutions focus more on contracts as a way to preserve the group going concern value. No matter where the subsidiaries are located and how closely they are related to each other, if creditors and debtors can voluntarily reach a new agreement, the danger of a group-wide insolvency will be temporarily avoided. The main approach is by renegotiation of debts or a wholesale of the business to senior creditors. The legal tools involved are used to facilitate relevant parties reaching a new agreement. If creditors are happy to amend or extend the debt maturity date, a group-wide cross-border insolvency can be avoided. Also, if the whole group could be sold together to creditors, the relationships among group members are preserved. Chapter 4 will discuss these solutions in more details.

At last, procedural cooperation provides a modest way to preserve group going concern value by means of a coordination and cooperation framework. Though such approach may be criticized as having low effectiveness, it provides better certainty to the creditors by respecting the insolvency jurisdiction and legal personality of each subsidiary. The group coordination proceeding in the EIR recast is based on this method which encourages courts and insolvency practitioners of different member states to cooperate and coordinate with each other. Amongst other things, the coordinator can be appointed with certain power to facilitate the draft of a group rescue plan. This part will be discussed in Chapter 5.
Chapter 3 Cross-border insolvency theories and procedural consolidation

The last chapter provides evidence that MCGs may have group going concern value worth preserving for the purpose of insolvency law, and it argues insolvency solutions of MCGs should respect the legal personality of the individual subsidiary so as to fulfil the goal of certainty.

This chapter completes the theoretical sub-objective in Chapter 1 by connecting the corporate rescue theories and multinational enterprise theories to cross-border insolvency law theories. It achieves this objective by examining universalism and territorialism, forum shopping and doctrines of CoMI. Also, it starts the examination of the first practical solution for the cross-border rescue of MCGs—procedural consolidation. In the light of conclusion from Chapter 2, this chapter will consider the ex ante and ex post approaches of procedural consolidation and their respective merits and demerits. Corporate rescue theory provides two values—preservation of going concern value and certainty—to examine the desirability of procedural consolidation. Also, multinational enterprise theories reveal certain characteristics of multinational corporate groups which affect the insolvency jurisdictional rules on which procedural consolidation relies. All these theories and implication will be taken into account in this chapter. The main purpose of this chapter is to explore whether procedural consolidation is a reliable solution for the cross-border rescue of corporate groups.
In contrast to radical and unnecessary substantive consolidation which denies the independent legal status of individual companies in the group, procedural consolidation respects the legal form of each member company. It does not aim to pool the assets and creditors' liabilities of different companies together. Rather, procedural consolidation aims to pull the group members in front of the same court to open insolvency proceedings. This can be done mainly by changing insolvency jurisdiction rules such that all the subsidiaries have rights to opening insolvency proceedings in the country of the parent company.

The current insolvency jurisdiction of one company in the EU is decided by the 'center of main interest' (hereafter CoMI) of one company according to the 'EU regulation on insolvency proceedings' recast (hereafter EIR recast). It is the cornerstone which underlies the jurisdiction-selection rules under cross-border insolvency theories and it is widely adopted in international insolvency law instruments. The concept of CoMI is based on universalism theory, which prescribes that the jurisdiction of insolvency of one multinational company should be allocated to the court which possesses the center of main interest of that company.

Also, it could be done by forum shopping so that the relevant factors of all the subsidiaries are moved to one country for the purpose of cross-border insolvency.

Whether procedural consolidation is a solution desirable for cross-border insolvency of MCGs will be examined with reference to the ability of the preservation of group going concern value and certainty. One thing that should be noted is that in the cross-border

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235 Both EC Regulation on cross border insolvency proceedings 2015 and UNCITRAL Model Law on cross border insolvency (thereafter Model law)1997 adopt CoMI as the determinant of cross-border insolvency jurisdiction.

236 See Chapter 4 for more details.
In insolvency context, procedural consolidation may still change creditors' rights by altering the insolvency law. In other words, after being pulled to a new jurisdiction, under the current choice of law rules, with certain exceptions, the insolvency law of that new jurisdiction will apply to the creditors. As a result, whether a predictable "ex ante" jurisdiction rule could be found or whether the forum shopping of insolvency courts is desirable in the EU are important questions that need to be answered. Without certainty, the procedural consolidation may face significant challenges as solutions for cross-border insolvency of MCGs.

The structure of this chapter is as follows. Firstly, it starts with cross-border insolvency theories which underpin the current jurisdiction rule - CoMI.\(^{237}\) The purpose is to assess whether CoMI is desirable than the jurisdiction rule that territorialism theory has offered. The analysis will be done with reference to the values of preservation of value and certainty, and the head office functions allocation with reference to group theories from Chapter 2. The thesis believes that though CoMI has certain drawbacks, it works better than rival insolvency jurisdictional rule. Secondly, it moves to analyse the ways to achieve procedural consolidation under CoMI. One way proposed by cross-border

insolvency theorists is group CoMI approach, which ex ante allocates one court as the jurisdiction for the whole group. Another is an ex post forum shopping approach. All these will be examined in turn. The thesis finally argues that despite procedural consolidation has the potential to preserve values, but only in limited cases. The uncertainty of rules makes procedural consolidation difficult to apply as a general rule for insolvency of MCGs.

3.1 Cross-border insolvency law theories on jurisdiction

3.1.1 Introduction

As Chapter 2 discussed, insolvency law provides one set of rules to deal with collective issues. The collectivity supersedes multiple individual actions for the purpose of going concern value preservation and certainty.

This collectivity makes rules consisting of the insolvency law of one country difficult to be disconnected, or replaced by the insolvency law of another country. One example could be the priority of creditors' rankings. Different countries may give different categories of creditors preference for various reasons. In other words, one creditor under the insolvency law of country A may enjoy certain priority that he would not enjoy under the insolvency law of country B. If creditors of one company but from different countries all argue that they should be treated according to their own countries' priority, no priority of ranking can be agreed and formed. As a result, the collectivity nature of insolvency law generally requires only one set of rules being applied to insolvency cases. The implication of this is that insolvency jurisdictional rules are to a large extent tied together with choice of law rules. Where one court is entitled to seize jurisdiction, it could apply its own
insolvency law to the given case, with some exception.

EIR recast reflects this idea by incorporating a set of harmonized insolvency choice of law rules (HICOL rules). The law of the court will decide the conditions of the opening of those proceedings, their conduct and their closure; also it decides many important aspects of bankruptcy law such as creditors' priority. To protect the local interests, the regulation also provides certain exceptions to lex fori concursus; for example, the effect of the insolvency proceedings on immovable property is only decided by the law where the immovable assets are situated.

The EIR recast requires all courts of member states to automatically recognize the insolvency proceedings opened by the courts which first seize the cases, and other courts can only challenge the jurisdiction in that court. Therefore, the Regulation confers much power to the court of opening insolvency proceedings, due to choice of law rules and automatic recognition. It is safe to say that the jurisdictional rule of cross-border insolvency law is of great importance. In the field of cross-border insolvency law, the main theories include territorialism and universalism. The two main cross-border

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238 EIR recast Article 7 See comments on previous EIR HICOL in general: Bob Wessels, *International insolvency law*, (Kluwer The Netherlands 2006)
239 EIR recast Article 7 (2)
240 EIR recast Article 8 - article 18
241 EIR recast Article 11
insolvency theories hold different views on the means of allocation insolvency jurisdiction. Territorialism argues that international insolvency cases should be regulated by courts in which the assets of the debtors are located. The ensuing result is that more than one court is entitled to open insolvency proceedings, due to various locations of assets in one typical cross-border insolvency case. Universalism argues that ideally, there should be one court and one set of bankruptcy laws to be applied to one cross-border insolvency case.

Beside universalism and territorialism as the main cross-border insolvency law theories, there are some other theories: contractualism\(^\text{245}\) and universal proceduralism.\(^\text{246}\) Since territorialism suggests that assets location determines the insolvency jurisdiction rule, which is different from the other theories that generally embrace CoMI,\(^\text{247}\) the next section will examine whether CoMI is superior to the assets jurisdiction rule.

3.1.2 Dichotomy on jurisdictional rules

3.1.2.1 Territorialism

Territorialism pits against universalism with the argument that insolvency proceedings of international companies should be opened in the courts where the assets of the companies are located.\(^\text{248}\) Pure territorialism does not offer any measures to cooperate with or recognize insolvency laws of other foreign courts.\(^\text{249}\)

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\(^{245}\) Contracts are used to allocate jurisdiction at the beginning.

\(^{246}\) It aims to centralize insolvency proceeding into one jurisdiction while applying local insolvency law to protect local creditors, for avoiding multiple insolvency proceedings.

\(^{247}\) One exception is that in contractualism it is possible for the parties to choose insolvency jurisdiction which is different from the location of CoMI.

\(^{248}\) One extreme form of territorialism is that local courts do not allow foreign creditors to file their petitions.

\(^{249}\) It is true that without treaties, there is no obligation for the countries to provide cooperation to the foreign courts and recognize the foreign judgments.
The courts under territorialism may be reluctant to transfer assets to the foreign courts where foreign insolvency proceedings are opened, as local courts insist on providing favoritism to local creditors. For example, one court provides no cooperation with foreign courts until local creditors are fully paid. 251 As all the courts can open insolvency proceedings which are equally independent, the cooperation and deference from foreign courts are difficult to obtain. This is especially true if many insolvency proceedings are opened. 252

The territorialists have realized that territorialism needs some reform to accommodate the need of going concern value preservation and international cooperation. These demands give rise to a reformed version-cooperative territorialism. Cooperative territorialism aims to achieve a wide cooperation between courts for the purpose of successful reorganization especially in the business integrated cases. 253 Professor LoPucki briefly provided the possible solutions to describe a viable cooperative territorialism: there are five suggestions to explain how cooperative territorialism could work: ‘1. The courts may set up a regime that could share the information of claims lists; 2. The representative may file one claim of the debtor in all other insolvency proceedings opened against the same debtor; 3. Cooperation between courts to conduct a joint sale, 4. Voluntary investment to the estate in other jurisdictions for the purpose of reorganization 5. Insolvency practitioners return the seized assets that should be returned, due to the avoidable

transfer.254

However, the basic principle is unchanged: each bankruptcy court has jurisdiction over the assets of one multinational company situated in its jurisdiction no more, no less.255 Nevertheless, it does not mean that territorialism only allows local creditors to enjoy locally seized assets. In fact, most countries' insolvency laws allow cross-filing256 even though they are based on territorialism.257 Also, it is possible that both of the theories may offer cross-priority258 to the foreign creditors.

3.1.2.2 Universalism

Universalism has gradually gained support from scholars and practice by assigning insolvency jurisdiction of one company to the court where the CoMI of the company is located. The tenet of universalism is that one single court administers one multinational insolvency case by applying its own insolvency law to it. One important justification for universalism is that it allows one set of insolvency laws to cover the market that the company in issue operates from, so that the functions of insolvency law could perform.259 As universalism respects the economic reality and business operation of the companies, reorganization of either one company or a group of companies may be facilitated.

Pure universalism is based on an ideal universalist rationale that the court of the home

256Cross-filing allows foreign creditors to lodge their claims in local insolvency proceedings.
258As long as foreign creditors fall into the categories that local insolvency law give priority, they can enjoy such priority without being discriminated due to their nationality.
country of a company should have the jurisdiction over all the assets of the company, even if there are some assets of the company in other jurisdictions. For insolvency law to be effective, one has to allow bankruptcy law to be applied to the extent that the debtor’s business has reached in the market.  

As there is only one court involved, so most of the insolvency-related issues are governed by the insolvency law of the court of opening the insolvency proceedings. In other words, it means that lex concursus (the law of the opening proceeding) should be the law to administer procedural aspects of insolvency and a number of the substantive insolvency issues. As a result, some financially weak local creditors will not suffer from uncertain different assets/claims rates.

Nonetheless, universalism imposes obligation on courts by forcing them to defer to foreign courts and foreign insolvency law. Here universalism may create friction that territorialism does not. Generally, pure universalism significantly extends the jurisdiction of one country to other member states, which makes these states reluctant to cede their sovereignty. Where some assets appear in other countries, the courts of those countries may be inclined to apply their own insolvency laws to the cases at issue. Even though certain courts advocate pure universalism, their judgments may not be recognized by other courts involved.

Under universalism, deferring to foreign insolvency laws means that pre-insolvency

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261 Such as the priority of claims and avoidance of transaction.
entitlements of creditors will be modified by a new set of rules. The insolvency laws of different member states may vary with regard to the approaches that they take. For instance, creditors' priority is the manifestation of how one specific country has chosen its hierarchy of values according to its policies.\textsuperscript{265} It is therefore difficult to substitute one country's priority for another's for creditors' protection.\textsuperscript{266} It is unlikely that the same priority (in terms of order or scale of protection) of creditors could be found in two country's insolvency law systems.\textsuperscript{267} Ignoring the priority of these preferential creditors is unfair to them.\textsuperscript{268} The consequence is that courts may be reluctant to defer to foreign courts.\textsuperscript{269}

Universalism may be more favourable to the more developed countries than less developed countries, as it is more likely that the multinationals incorporate in the former. As a result, some highly developed countries' insolvency law and social policies may have more chance of being applied and exported to other countries.

Considering the difficulties of adopting pure universalism, a modified universalism becomes a compromise.\textsuperscript{270} The feature of modified universalism is that it keeps the main characters of the pure universalism by only allowing one main proceeding to work as a leading proceeding while absorbing territorialism elements by permitting local courts which possess establishments (such as branches) to open secondary proceedings, for the purpose of local interest protection and creditors' expectations.

\textsuperscript{265}Jose M. Garrido, ‘No two snowflakes the same: the distributional question in international bankruptcies’ (2010-2011) 46 Tex. Int'l L. J. 459 p474
\textsuperscript{266}ibid p475
\textsuperscript{267}See a taxonomy of creditors priorities in Jose M. Garrido, ‘No two snowflakes the same: the distributional question in international bankruptcies’ (2010-2011) 46 Tex. Int'l L. J. 459
\textsuperscript{270}But one should not exaggerate the issue of protection of foreign creditors in the universalism context. The fact should be noted that non-adjusting creditors' debt may be marginal in comparison with adjusting creditors' debt. Also, unsecured trade creditors do not enjoy priority in many countries' system. Edward S. Adams, Jason K. Fincke, ‘Coordination cross border bankruptcy: how territorialism saves universalism’ (2008-2009) 15 Colum. J. Eur. L. 43 p54
Modified universalism takes local creditors’ interests into account by opening secondary
proceedings.\(^{271}\) In secondary proceedings, it is the law of the court which opens
secondary proceedings that will be applied instead of the insolvency law of the main
proceedings. Where one member state confers a privilege under local law to categories of
creditors, such privilege may be protected by opening secondary proceedings.\(^{272}\) Such
compromise may provide a viable solution to protect local creditors such as wages, taxes
and secured claims.\(^ {273}\)

However, secondary proceedings still need to defer to the main proceedings to some
degree, otherwise the cooperation and coordination will lose their basic grounds.\(^{274}\) It
alludes that modified universalism would be the direction of development of future cross-
border insolvency law, and arguably 'the smoothest and fastest transition to true
universalism'.\(^{275}\)

Arguably, modified universalism can still achieve the same results as pure universalism.
It does not preclude the situation where only one main proceeding opens without the
opening of other secondary proceedings. Re Nortel Networks SA case\(^{276}\) concerns the
insolvency of the European sub-group of the Nortel group based in North America. The
English court opened the main insolvency proceedings for all the European subsidiaries in
the group according to the EU regulation. The joint administrators of the English

\(^{271}\) National priority system may be quite idiosyncratic. Arguably, the difference could be found in size,
scope, identity of creditors, and order of priority. For example, the compensation for fishermen under the
US bankruptcy law only allows fishermen who have US citizenship to file such claims. Without paying the
priority claims in a foreign court, it is very difficult to receive cooperation from other court, such as remit of
assets. see Allan L. Gropper, ‘The Payment of Priority Claims in Cross-Border Insolvency Cases’ (2010-
2011) 46 Tex. Int’l L. J. 559 p562


\(^{273}\) ibid p431; Jay Lawrence Westbrook ‘Breaking away: local priorities and global assets.’(2010-2011) 46
tex. Int’l L. J. 601 p615

\(^{274}\) As Virgos-Schmit Report states: ‘The rationale behind the rule is that economic operators conducting
their economic activities through a local establishment should be subject to the same rules as national
economic operators as long as they are both operating in the same market.’ Virgos-Schmit Report para 71

p2277; Edward s Adams, Jason k. Fincke ‘Coordinating cross-border bankruptcy: how territorialism saves
universalism’ (2008-2009) 15 colum.j.eur. L. 43 p52; Jay Lawrence Westbrook ‘Universalism and Choice of

\(^{276}\) Re Nortel Networks SA, [2009] EWHC 206 (Ch) p1
insolvency proceedings applied to the English high court for a letter of request to all the courts in other member states. The aim of such letter was to request foreign courts to inform the English administrators regarding any application to open secondary proceedings. Therefore, the English administrators could provide reasons why the opening secondary proceedings might not in the interests of creditors. The English court approved the request; it was of the opinion that as insolvency practitioners in main proceeding and secondary proceedings had obligations to cooperate with each other, and it was desirable that insolvency practitioners in the main proceeding were given notice of any request to open secondary proceedings which were harmful to the successful corporate rescue. This case shows that if the group members’ insolvency proceedings are opened in one court, cooperation between member states may be desirable such that other member states will not wage secondary proceedings to act against main proceedings.

Also, modified universalism can exert a more effective cooperation than that under cooperative territorialism. This is because the cooperation is in a hierarchical structure whereby only one main proceeding can be open, and the insolvency practitioner in the main proceeding is given more power than those in secondary proceedings. Insolvency practitioners in the main proceedings enjoy more power than ones in secondary proceedings. Modified universalism also requires courts and insolvency practitioners in the main and secondary proceedings to coordinate with the main proceeding to achieve better results.

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277 ibid p1
278 ibid p2
279 The impact of the secondary proceeding will be confined to the assets seized by the local court, so it has no impact to the assets out of the border of the local jurisdiction.
280 Main proceeding insolvency practitioners are given priority to make group rescue plan. EIR Recast Article 41
The HIH case\(^{281}\) is an example of such cooperation and deference between main courts and secondary courts. The background of this case is that four Australian incorporated insurance companies were in insolvency, while the CoMIs of these companies were in Australia.\(^{282}\) The Australian court requested the UK court to turn over the assets in the UK after paying the relevant liquidation cost; and the Australian court would distribute them under Australian insolvency law. The contradiction is, Australian insolvency law grants insurance creditors priority, while under UK insolvency law, such creditors have no priority.\(^{283}\) The consequence of the assets remit would lead the English general creditors to a different result, as they would not receive the distribution *pari passu* with the Australian insurance creditors.

Lord Hoffmann allowed the assets transfer to Australia, as this was the embodiment of the ‘unitary and universality’ of cross-border insolvency law principle.\(^{284}\) The doctrine of ancillary insolvency proceedings is to assist the principal proceeding. This inevitably entails the UK courts applying foreign insolvency law but dis-applying all or part of English law after remittal of assets in some cases. Therefore, if the pre-condition to approve an asset remittal to a foreign court is based on the foreign law being similar to English law, then such remittal is meaningless.\(^{285}\) In HIH case, the connection of debtors was close to Australia, so applying Australian insolvency law was in line with creditors’ expectations. One cannot reject it simply because another country has a different preferential creditors list as rarely can one find two countries’ priority rankings are the same; remitting assets does not breach the justice and public policy of English courts.\(^{286}\)

\(^{281}\) In re HIH Casualty and general insurance ltd [2008] 1 W.L.R.852
\(^{282}\) ibid para31
\(^{283}\) ibid para2
\(^{284}\) ‘There should be a unitary bankruptcy proceeding in the court of the bankrupt's domicile which receives worldwide recognition and it should apply universally to all the bankrupt's assets' In re HIH Casualty and general insurance ltd [2008] 1 W.L.R.852 para 6
\(^{285}\) In re HIH Casualty and general insurance ltd [2008] 1 W.L.R.852 para21
\(^{286}\) ibid para34
With the HIH case, the CoMI was in the Australia; and creditors who signed insurance contracts with those Australian insurance companies should have expected that it was Australian law that would be applied. Though there were some assets in the UK, but it would not be expected that the insurance policies would be intervened by the place of assets.\textsuperscript{287} The fact that different laws yielding different distributional results does not breach public policy, as the foreign law does not inherently treat creditors unfairly. Without convincing evidence or reason to not cooperate, courts and creditors should accept the difference under this circumstance.

Some may argue that the reason why the UK court offered cooperation with discretion was partly because Australia is on the list\textsuperscript{288} of counties to which the UK may provide recognition and cooperation. However, Lord Hoffmann’s main judgment is mainly on the basis of the principle of modified universalism which allows English courts to provide cooperation to other courts within the extent not breaching English public policies.\textsuperscript{289} One could argue that if modified universalism is the principle that underpins cooperation, the scope of countries which are qualified to enjoy cooperation under \textsc{s}426 should be available to other jurisdictions as well.\textsuperscript{290} As the EU regulation formally requires not only the insolvency practitioners but also the courts to cooperate with each other, there should arguably be similar deference from secondary proceedings to the main proceeding.

In the Cambridge gas case\textsuperscript{291}, Lord Hoffmann said that: ‘The English common law has traditionally taken the view that fairness between creditors requires that, ideally, bankruptcy proceedings should have universal application. There should be a single bankruptcy in which all creditors are entitled and required to prove. No one should have

\begin{footnotesize}
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\item \textsuperscript{287}ibid para33
\item \textsuperscript{288} Insolvency Act 1986 S.426
\item \textsuperscript{289} Hamish Anderson, ‘Ebbs and flows of universalism’ (2015) Recovery Summer p8
\item \textsuperscript{290} Hamish Anderson, ‘Ebbs and flows of universalism’ (2015) Recovery Summer p10
\item \textsuperscript{291} Cambridge Gas Transportation Corpn v Official Committee of Unsecured Creditors of Navigator Holdings plc and others [2007] 1 A.C. 508
\end{itemize}
\end{footnotesize}
an advantage because he happens to live in a jurisdiction where more of the assets or fewer of the creditors are situated; universality of bankruptcy has long been an aspiration, if not always fully achieved, of United Kingdom law. And with increasing world trade and globalization, many other countries have come round to the same view. This further confirms the merits of modified universalism.

Which theories can offer better solutions to cross-border insolvency entails a comparison of CoMI and grab rule in terms of respective abilities to preserve going concern value and to provide certainty. The certainty of these jurisdiction rules will be affected by forum shopping. Whether the vulnerability to forum shopping is necessarily negative largely dependent on whether the forum shopping in cross-border insolvency context is generally desirable. If it is not, the next question to ask is whether the CoMI supported by universalists can do better than grab rules advocated by territorialism with respect to prevention of forum shopping. The next section starts to examine the desirability of forum shopping in cross-border insolvency in the EU.

3.2 Forum shopping

The disparities of national insolvency law and other relevant laws, such as secured credit law and employment law, may render forum shopping difficult to avoid. Debtors and creditors can seek varying degrees of efficiency of insolvency proceedings, debt restructuring mechanisms, credit recovery rates and investor protection from different member states.

292 ibid p9
294 For example, from the statistics regarding the cost of bankruptcy for banking creditors, the cost of bankruptcy proceeding of UK is lower than other member states such as Italy, France and Germany. Also, the length of UK’s bankruptcy proceeding is also shorter than those in above mentioned countries. Another thing noteworthy is in terms of percentage of credit recovery, the UK bankruptcy procedures can yield 70% percentage credit recovery for preferential creditors, which is far ahead of the French procedure.
What attitude should one have to forum shopping in cross-border insolvency context is an important question. This section will examine whether forum shopping can preserve value and bring in certainty. The answer to this question can help to analyze the desirability of certain procedural consolidation via forum shopping.

3.2.1 Theoretical views on forum shopping

Forum shopping in the insolvency context may be defined as moving assets or CoMI from one country to another so as to benefit from the substantive or procedural law of the latter. As insolvency laws of member states are not harmonized, creditors or debtors may have incentives to conduct forum shopping and to seek favourable insolvency law in their own interests. One example could be that senior creditors may prefer UK insolvency law to French insolvency law as English insolvency law grants creditors more power to control the insolvency proceedings.

There are two concerns with the consequences of forum shopping. One is whether forum shopping can benefit creditors of one distressed company in general by choosing a more effective insolvency law of another country. The second is that even if forum shopping performance preferential creditors. Comparing UK insolvency procedure to French one, UK procedure could more likely to save a business as a going concern with the recovery rate 88.6%, while French insolvency proceeding achieves the recovery rate 48.3%. Also, UK procedure need one year on average, while French procedure needs 1.9 years. Moreover, the UK procedure cost 6% of the estate, while the French costs 9% of the estate. From this comparison, the UK insolvency procedure contains relative advantages over the French one, so that the French company may be more likely to transfer to UK to conduct insolvency. Impact assessment on the directive on the cross border transfer of registered office Brussels, 12.12.2007 annex table at p 11, 12

295 Gerard McCormack, 'Bankruptcy forum shopping, the UK and US as venues of choice for foreign companies' (2014) International and Comparative Law Quarterly 04 63 p815
296 Such as the availability of rescue or restructuring proceedings; treatment and priority of creditors; ability to cram down dissenting creditors’. Forum shopping and COMI shifting –overview Rationale Practice note, Lexis PSL.
297 Wolf-Georg Ringe, 'Forum shopping under the insolvency regulation' European Business organization law review p599
can maximize value of the debtors' assets, will the uncertainty caused by forum shopping tolerable? The two concerns will be examined below.

3.2.1.1 Maximization of value

When creditors seek forum shopping for the purpose of changing insolvency law, one may assume that the purpose of such a change is to preserve the going concern value of one distressed company that the local insolvency law cannot do. However, generally speaking, forum shopping is a pejorative word. Creditors with conflicting interests may be more likely to choose the insolvency law that only benefits themselves rather than preserving value for creditors in general. Any insolvency law is not perfect, so the weakness of a given insolvency law can be taken advantage of by some creditors. For example, the holding companies in corporate groups try to move CoMIs to another country with the intention of selling the whole operating subsidiaries to the potential buyers via a pre-pack sale.\(^{298}\) The pre-pack sale may make it difficult for junior creditors in other countries to challenge due to a lack of transparency. Such practice may be used by senior creditors to wipe out junior creditors.

Other costs of forum shopping also arise. One could be that forum shopping may overburden some courts and so reduce their efficiency to resolve insolvency cases.\(^{299}\) The court being shopped for may not necessarily provide better than average service; arguably, the Delaware court seems to be more likely to rubber-stamp the approval of the pre-pack cases without achieving more efficient and certain reorganization results than rival courts.

\(^{298}\) HHY Luxembourg S.A.R.L & Anr v Barclays Bank PLC & Ors [2010] EWHC 2406
\(^{299}\) Paschalis Paschalisdis, ‘Freedom of establishment and private international law for corporations’ (OUP 2012) p216
in other states.\textsuperscript{300}

Also, forum shopping itself will incur cost due to the relocation of CoMI. One should note that a real relocation of CoMI means that subsidiaries may truly move main business from one country to another. In the MCGs context, such practice may be likely to cause significant cost as the subsidiaries' relationships with foreign suppliers and environment may be cut off. This prevents the group from gaining advantage from the foreign countries. Last but not least, forum shopping incurs costs to local creditors as they may have to travel to participate in the foreign insolvency proceedings.

Some may argue that if forum shopping serves as a tool to maximize the bankruptcy estate on behalf of all the creditors, it should be allowed; by contrast, if forum shopping is conducted only for the purpose of transferring value from creditors to debtors, it should be prohibited.\textsuperscript{301} Such assertion is deduced from EIR recitals\textsuperscript{302} which pursue the goals of preservation of value and anti-fraudulent forum shopping.\textsuperscript{303} Some believe that the goal of maximization of assets to creditors is superior to the goal of anti-forum shopping where there is a conflict between them.\textsuperscript{304}

The reasoning of the above belief relies on the fact that the EU does not take measures to fix the concept of CoMI so as to make forum shopping impossible. Uncertainty of anti-forum shopping rules will lead to increase of cost; some creditors may not reject a better

\textsuperscript{301}Horst Eidenmüller ‘Abuse of Law in the Context of European Insolvency Law’ (2009) European Company and Financial Law Review 6(1) p10
\textsuperscript{302}Recital 2, 8, 16, 19, 20 and recital 4
\textsuperscript{304}ibid p8; Federico M. Mucciarelli, ‘Private international law rules in the Insolvency Regulation Recast: a reform or a restatement of the status quo?’ (2015) p13
recovery provided by foreign insolvency law. This argument is not convincing as EIR recast clearly provides a series of mechanisms to avoid forum shopping. For example, the EU regulation recast includes the suspect period of CoMI moving by saying that if the registered office has been transferred from one jurisdiction to another within three months prior to the opening of insolvency proceedings, the new registered place cannot be used as presumption of CoMI. No rule can provide absolute certainty. The shortcoming of CoMI does not imply EIR's acquiescence on forum shopping.

It is true that in some cases, forum shopping is conducted just for the purpose of seeking a flexible restructuring scheme and benefiting creditors, for instance, where desirable reorganization procedures of one jurisdiction provide a good solution to conquer hold-out issues. In the Schefenacker case, the unanimous approval by all the bondholders inevitably made a restructuring impossible, as the threshold provided bondholders significant hold-out power to hinder a rescue which would have benefited all creditors.

After consideration, among other things, it is desirable to conduct a debt to equity swap restructuring which has the effect of deleveraging; it may save the business from the threat of liquidation insolvency proceedings. However, under German insolvency law(before reform of German restructuring law), such debt to equity conversion requires a

306 See regulatory view of forum shopping below.
307 New EU regulation article 3(1)
310 Schefenacker is the key manufacture of automotive lights and mirrors. Its base is in Germany and occupies 28 percent of market share in the world before facing financial difficulty in 2006; it will affect the market strongly, given its weight and share on the supply end. 2007 KPMG International 12 Seeing the light Restore October 2007 KPMG International 12 Seeing the light Restore October 2007; see also Samantha Bewick, ‘Schefenacker plc: A Successful Debt-for-Equity Swap’ (2016) International Corporate Rescue, Volume 5, 2
unanimous approval from the bondholders which is not a viable option.\textsuperscript{312} By contrast, the UK company voluntary arrangement (CVA) is very flexible, as it requires 75 percent of bondholders’ approval. Also, it allows the guarantee of the bonds given by the operational companies to be released under the same process.\textsuperscript{313} The result was successful.\textsuperscript{314}

Attention should be given to the fact that the reformed German restructuring law now permits debt to equity swaps\textsuperscript{315}; therefore, such costly CoMI shifts may be outdated and be a less attractive option. The modernized national insolvency law is a better option than forum shopping.

The Re Zlomrex International Finance SA case can be seen as another example. Zlomrex International Finance SA is a French finance company of one polish group. Its purpose is solely to raise finance for the whole group. When it faced financial difficulty repaying its debts, it proposed to move CoMI to London to benefit from a scheme of arrangement for its bond notes.\textsuperscript{316} In fact, it is very clear that all the conduct of forum shopping was solely in order to use schemes of arrangement to avoid insolvency and cross default of the group members had the French restructuring been used.\textsuperscript{317} In such cases, the UK’s flexible scheme of arrangement would allow the bonds to be substituted by new bond notes, and delay them to next year; more importantly it helped the group to avoid insolvency.\textsuperscript{318} It is possible to argue that as the forums shopping happened at holding company level, the

\textsuperscript{312}Samantha Bewick, ‘Schefenacker plc: A Successful Debt-for-Equity Swap’ (2016) International Corporate Rescue, Volume 5 2 p104
\textsuperscript{313}ibid p104
\textsuperscript{314}It should be noted that in Schefenacker case, the comi shift subject is the holding company of the group, but not be the operational companies in 12 European countries. As the holding company has no employees and trading creditors, it is easier to move comi from one jurisdiction to another. Even so, such movement has been approved by the majority of stakeholders, which enhance the justification of such movement. Samantha Bewick, ‘Schefenacker plc: A Successful Debt-for-Equity Swap’ (2016)International Corporate Rescue, Volume 5 2 p104
\textsuperscript{315}2012, Act for the Further Facilitation of the Restructuring of Companies” (Gesetz zur weiteren Erleichterung der Sanierung von Unternehmen, ESUG)
\textsuperscript{316}Re Zlomrex International Finance SA[2013] EWHC 3866 (Ch)
\textsuperscript{317}ibid p3
\textsuperscript{318}ibid p3
financial creditors may have acknowledged the risk of change of governing law of contract or insolvency law.319

It seems plausible to argue that opting for a more desirable and flexible applicable law by forum shopping does not itself constitute bad forum shopping, as local law may not provide a good solution to resolve the commons(collective insolvency proceeding) and anti-commons(hold-out issue by certain creditors) problems in insolvency.320 In other words, the insolvency law and restructuring law are designed to provide solutions for insolvency and restructuring issues; where the local law does not provide a solution, it seems to be tolerable to choose another set of rules simply to overcome the issues such as hold-out. However, the changed substantive rights and procedural rights may affect a large number of creditors in terms of their final gain. It is difficult to determine whether the total value of the going concern value has been enlarged and whether there is value redistribution from junior creditors to senior creditors as a consequence of the forum shopping.

3.2.1.2Certainty

As above mentioned, the main purpose of forum shopping in a cross-border insolvency context is to seek favourable insolvency law of another country. An almost inevitable consequence is that forum shopping changes the insolvency forum and applicable law, which brings in uncertainty.321 As insolvency law is closely connected to the advance of credits, alteration of insolvency laws will cause uncertainty which affects solvent

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319 Some debt instrument may contain majority voting clause either to change key terms of the contracts. For example, it is possible to change the governing law of the contracts. The presence of such clause may cause financial creditors to recalibrate the interest rate of loans.
321 Paschalis Paschalisdis, Freedom of establishment and private international law for corporations (OUP 2012) p216
companies. In this regard, forum shopping is generally undesirable.

Financial creditors may rely on an anti-forum shopping covenant to require debtors not to move CoMI; also they may seek to require unanimous consent in the governing law and jurisdiction law clause. However, even such covenant may not essentially endow adequate protection to creditors if debtors deliberately try to break such a covenant and transfer CoMI to another jurisdiction. When it comes to trade creditors, who in most of the cases do not have bargaining power to request an anti-forum shopping covenant, their risks can be more difficult to assess.

There seems to be a case to make that if forum shopping happens in the holding companies and only adjusted creditors are affected with their own consent, forum shopping may not be that susceptible. Certain holding companies in the group may not conduct day-to-day activities except arranging financing for the group. Therefore they do not have numerous staff and trade creditors. Relatively, moving the CoMI of a financing company is easier than operational companies. If the local insolvency law will lead to liquidation of the whole corporate groups and loss of value, the justification of forum shopping may be enhanced. Forum shopping of this kind may not only preserve the going concern value, but also least affect the creditors' expectation. However, such cases may be limited in reality as not all the corporate groups arrange financing in the same way.

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322 Vanessa Finch, Corporate insolvency law perspectives and principles (Second edition Cambridge university press 2009) p69
323 Kathy Stones, 'UK schemes and forum shopping' (2014) 4 CRI 161 p4
325 Due to the fact that holding company may not have trade creditors, it is much easier for the holding companies to shift comi than operational companies. GeoffO’dea Julian Long and Alexandra Smyth, Schemes of arrangement Law and practice. ( OUP 2012) p25
326 Kathy Stones, 'UK schemes and forum shopping' (2014) 4 CRI 161 p3
328 This type of forum shopping happens with majority senior creditors' agreement, where these creditors can anticipate the risks when they lend money.
3.2.2 Forum shopping and freedom of establishment

It appears that forum shopping may find support from the principle of freedom of establishment. According to the TFEU art. 49 and art. 54, the freedom of establishment requires that restrictions of one member state on the free movement of establishment of a person (legal person or natural person) from another member states regarding setting up branches or subsidiaries, agencies or moving to another member state is prohibitive. Companies set up in one member state should be respected and recognized in other member states.

The EIR sets forth that CoMI is presumed to be the registered place of one company, unless there is evidence showing CoMI is in another country to rebut such presumption. As a result, debtors and creditors may have incentive to transfer CoMI and registered place to another member state. Relocation of either CoMI or registered places will have to deal with the mixed applicable company law system of the EU: the incorporation principle that requires company law to be governed by the law of registered place; real seat principle which requires company law to be governed by the place of head offices or location of main business.

With the influence of this mixed system, one should not assume that forum shopping can happen only by doing some paper work. For example, assume that there are two countries A and B, both embracing incorporation principle; moving registered place from member state A to B is not without obstacles. Country A will require the company to wind up first,

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329 TFEU Art. 49
330 TFEU Art. 54
331 Compared to moving comi, moving registered place may not successfully change the applicable insolvency law, as creditors may challenge it by showing the comi is in another country different from the new location of registered place.
332 Impact assessment on the directive on the cross border transfer of registered office Brussels, 12.12.2007 p9
as the company has changed the connecting factor, i.e. registered place, such that it is no longer the company subject to the company law of country A. The general rule is that, only the CoMI of companies could be transferred from home country to host country while retaining their status in the home country without change of applicable company law to them. When it comes to transfer of registered place, one company may not simply move its registered place from one country to another without winding up and dissolution, since both incorporation and real seat principles prevent such movement. Nonetheless, the recent Cartesio case seems to indicate that country A is enjoined to force the company winding up with reference to free movement of establishment, while it allows country B’ substantive law to hurdle the movement of registered place, for example, by forcing the company to reincorporate under country B’ law. There is no

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333 C-81/87Daily Mail 1988 ECR 5483 ECJ held that free movement of establishment does not prevent member states to decide how the companies can retain or lose legal status under their relevant law, as companies are nature of national company law.


336 As a result, moving registered place as a way of forum shopping for insolvency law will incur a significant cost, as winding up entails paying debts, which may trigger the insolvency proceeding immediately. see also The proposal for 14th company directive is again put on the agenda of EU parliament. In its recommendation 6(on protective measures), it clearly says: ‘Any company against which proceedings for winding-up, liquidation, insolvency or suspension of payments or other similar proceedings have been brought should not be allowed to undertake a cross-border transfer of seat. For the purposes of ongoing judicial or administrative proceedings which commenced before the transfer of seat, the company should be regarded as having its registered office in the home Member State. Existing creditors should have the right to a security deposit.’ Such protective provision shows that EU is cautious of the transfer of register place of companies in the context of insolvency. European Added Value Assessment EAVA 3/2012,Directive on the cross-border transfer of a company’s registered office 14th Company Law Directive, European Parliament resolution of 2 February 2012 with recommendations to the Commission on a 14th company law directive on the cross-border transfer of company seats (2011/2046(INI)) p44

337 Case C-210/06 Cartesio Oktato’ Szola Itato’ bt [2008] ECR I-9641

338 The ECJ held that member states have right to choose connecting factors to determine the applicable company law, and such connecting factors such as real seat alone does not infringe free movement of establishment. Paschalis Paschalisdis, ‘freedom of establishment and private international law for corporations’ 2012 OUP p77 Carsten Gerner-Beuerle and Michael Schillig, ‘The mysteries of freedom of establishment after Cartesio’ (2010) International and Comparative Law Quarterly Vol.59 p311
need to enter into the debate regarding the exact fault line between free movement of establishment of companies. Here one important point to make is that free movement does not guarantee companies in the EU to transfer registered place without any constrains.

A more important question is whether prior to insolvency, distressed companies are benefited by the free movement of establishment to shop for insolvency law. One thing that should be clear is that free movement of establishment only guarantees real mobility, but it should not be interpreted as allowing parties to free choice of insolvency law.\textsuperscript{339} Also, alteration of creditors' rights by forum shopping infringes the imperative public interests such as creditors’ protection-the Gebhard test.\textsuperscript{340} Therefore, the ECJ clarifies that freedom of establishment could be compromised by national law\textsuperscript{341} and the Gebhard test.\textsuperscript{342} Therefore, free movement of establishment is not an excuse for forum shopping prior to insolvency.

3.2.3 Regulatory view on forum shopping

The European Commission has acknowledged that not all the forum shopping activities that have happened in cross-border insolvency context are harmful.\textsuperscript{343} As mentioned above, it is possible that the purpose of forum shopping is solely to achieve a better result than the local insolvency law can provide.\textsuperscript{344}

\textsuperscript{339}Eva-Maria Kieninger, ‘The legal framework of regulatory competition based on company mobility: EU and US compared’ (2005) 6 German L.J. 741 p763
\textsuperscript{341}Carsten Gerner-Beuerle and Michael Schillig, ‘The mysteries of freedom of establishment after Cartesio’ (2010) International and Comparative Law Quarterly Volume 59 (2) p310
\textsuperscript{342}Gebhard v. Consiglio di Milano Case C-55/94 [1995] E.C.R. 4165
\textsuperscript{343}COM(2012) 743 final para 3.1
\textsuperscript{344}COM(2012) 743 final para 3.1
Some may also realize the changes of wording in the EIR recast regarding the attitude of forum shopping. Now it appears that the EIR recast is against the fraudulent and abusive forum shopping which is detrimental to general creditors. Though EIR recast does not provide any explicit explanation regarding these concepts, it is not convincing to interpret these changes as permission for forum shopping in cross-border insolvency law.

EU regulation does not allow free choices of insolvency law; nor is the jurisdictional competition of insolvency law encouraged. The problems of forum shopping discussed above present a case for the EU to discourage forum shopping in general. However, as long as the insolvency laws are different in member states, certain parties in companies have incentives to shop for better rules in their own interests.

Difficulties exist to judge whether forum shopping is done with the intention to fraud creditors. It could be argued that the evidence of blatant fraudulent forum shopping with the purpose of avoiding liabilities is not clearly seen. The uncertainty of the valuation of the business and the senior creditors' power to choose applicable law may at least make one doubt the intention of forum shopping even though it may be just perception but not reality.

The relevant provisions of EIR recast indicate that EIR recast actually has enhanced the

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345 In the previous version of EU regulation, the wording over forum shopping is as follows. ‘Recital (4) It is necessary for the proper functioning of the internal market to avoid incentives for the parties to transfer assets or judicial proceedings from one Member State to another, seeking to obtain a more favourable legal position (forum shopping).’ Council Regulation on insolvency proceeding (EC) no 1346/2000 Recital (4); By contrast, the EIR recast provides that Recital (29) This Regulation should contain a number of safeguards aimed at preventing fraudulent or abusive forum shopping.’ New EU regulation on insolvency proceedings 2015

346 Regulation (EU) 2015 2015/848 of the European parliament and of the Council of 20 May 2015 on insolvency proceedings New EU Regulation Recital 5 and Recital 29; see also Mark Arnold ‘the insolvency regulation: a service or an overhaul’ (2013) South square digest February p37


349 Ibid p6
mechanisms to prevent forum shopping. The new EU regulation contains five mechanisms to prevent forum shopping. These are suspect period, transparency mechanism, jurisdiction examination, creditors’ challenge and secondary proceedings.

a. Suspect period

Article 3 of EIR recast prescribes that in terms of a legal person, the registered place is presumed to be the place of CoMI if there is no evidence to the contrary. However, provided that the registered place is moved to another jurisdiction within three months prior to the opening of insolvency proceeding, such presumption does not apply.350

This three-month suspect period is a new mechanism aiming to prevent fraudulent and abusive forum shopping. It also manifests the objective of the new EU regulation to prevent forum shopping by shifting registered place shortly before opening insolvency proceedings.

b. Transparency

The new EU regulation also introduces a registration and publication mechanism, whereby the transparency of information with respect to the opening of insolvency proceedings and the appointment of insolvency creditors will be increased.

Art 24 (1) prescribes that the member state should establish an insolvency case register system, of which the information regarding the opening of insolvency proceedings should be disclosed by the member states immediately after the opening of such proceedings. Art24(2) goes on write that:

‘(a) the date of the opening of insolvency proceedings;

350 EIR recast 2015 Article 3
(c) the type of insolvency proceedings referred to in Annex A opened and, where applicable, any relevant subtype of such proceedings opened in accordance with national law;

(d) whether jurisdiction for opening proceedings is based on Article 3 (1), 3 (2) or 3 (4);’

Under Art. 25 the European commission will set up a system to interconnect the register system of each member state. This system will facilitate creditors and other parties having access to the information of opening insolvency proceedings in other jurisdictions.

Article 28 imposes publication obligation that:

‘1. The insolvency practitioner or the debtor in possession shall request that notice of the judgment opening insolvency proceedings and, where appropriate, the decision appointing the insolvency practitioner be published in any other Member State where an establishment of the debtor is located in accordance with the publication procedures provided for in that Member State. Such publication shall specify, where appropriate, the insolvency practitioner appointed and whether the jurisdiction rule applied is that pursuant to Article 3(1) or (2).’

The merits that the transparency mechanism could bring in are two-fold. On the one hand, it requires the courts of opening insolvency proceedings to provide information regarding the reasons to open insolvency proceedings. For example, the courts need to explain whether the insolvency proceeding are the main proceedings or secondary proceedings. It implicates that for the purpose of opening main proceedings, the courts should be satisfied that the CoMIs are indeed in their territory. Compared to the EU regulation 2000, under the new EU regulation, the courts cannot assume jurisdiction without giving adequate reasons. Another aspect is that creditors who know about the opening of
insolvency proceedings may challenge the jurisdiction provided that they possess sound evidence to the contrary.

c. Jurisdiction examination

Under the Art.4 of the EIR recast, it articulates that the court of opening insolvency proceeding shall examine its jurisdiction and writes reasons to assume jurisdiction in the judgment. Also, administrators are required to examine jurisdiction under Art4 (2).

Jurisdiction examination is left to the national courts which open of cross-border insolvency proceedings. As a result, to file insolvency proceeding immediately after forum shopping may run the risk of not being recognized. The English courts give more weight to external factors, such as registered office address, notification to the creditors and public, office place location and bank account.

The main merit of jurisdiction examination is to provide safeguard mechanism so that the insolvency proceedings could be examined and challenged. Though judges enjoy discretion to interpret CoMI, the inconsistence of their judgments can be mitigated by jurisdiction examination. The HBH case can be seen as an example.

HBH was a company incorporated in England and Wales. The English administrator opened a main proceeding in the UK. However, the employees in Germany also applied to the German court to open an insolvency proceeding. The German court did not realize that a UK insolvency proceeding had been opened; when it thereafter acknowledged it, it

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352 ibid p25
354 Hans Brochier Holdings Ltd v Exner[2006] EWHC 2594 (Ch)Warren J.
355 ibid.
denied it based on the public interests provision in the EU regulation, as the case in front of it obviously showed the CoMI was in Germany. After the administrator in the England was informed that the CoMI was in the German, the English administrator applied to high court in England to invalidate the order of opening insolvency proceeding in the UK. This case happened prior to the draft of EIR recast. One may expect that Art. 4 will help to avoid similar issues in the future.

d. Creditors’ challenges

Article 5 of EIR recast provides that the debtor and creditors may also challenge in front of the court regarding the international proceedings. Therefore, the CoMI location claimed by the debtor facing two levels of scrutiny: one is the examination of courts, another is the challenge from other parties. As abusive forum shopping may be unilaterally launched by debtor, the impaired creditors have strong incentives to challenge the shift.

Creditors’ challenge may correct the issue that CoMI could be shifted unilaterally. Just as what Professor LoPucki asserts, current US bankruptcy forum shopping is an example which is serving only the interests of the parties who conduct the forum shopping rather than the general interests of all the parties.358

The ultimate power to decide whether to accept or dismiss creditors' challenge is still conferred to the courts of member states. As long as the courts are convinced that CoMIs

357ibid p586
358Lynn LoPucki, Courting failure: how competition for big cases is corrupting the bankruptcy courts, (The University of Michigan press 2006) p251
are in their territory after examination and challenge, the court should be able to open international insolvency proceedings. However, with good faith and due care, the challenge from the creditors may provide courts with more information to reconsider and examine the CoMI location.

e. Secondary proceedings

The last recourse is secondary proceedings.\(^{359}\) As it may interrupt the main proceeding, local creditors can gain some bargaining power against the insolvency practitioner in the main proceeding. Secondary proceedings can protect local creditors where obvious abusive and fraudulent forum shopping has been carried out.

All these mechanisms show EIR recast is still cautious about forum shopping. It is submitted that the different national insolvency laws will lead to forum shopping cases irrespective of these protection mechanisms,\(^{360}\) while it is not safe to open the door for ‘good forum shopping’ especially when the distinction is unclear.

Arguably, forum shopping may partly result from manipulation the concept of CoMI.\(^{361}\) Some scholars suggest replacing CoMI by registered place, whereby greater predictability could be achieved.\(^{362}\) However, such proposal may be vulnerable to dealing with letter box companies which are registered in country A while doing almost their entire business in another country B. The result is that the even though B country’s interest is closely

\(^{360}\)ECJ provided that any measures “liable to hinder or make less attractive the exercise” of the freedom of establishment “must be applied in a non-discriminatory manner; they must be justified by imperative requirements in the public interest; they must be suitable for securing the attainment of the objective which they pursue, and they must not go beyond what is necessary in order to attain it.”
related to the business, its insolvency law cannot be applied to protect the creditors it aims to protect. Another shortcoming exists in the context of the corporate groups. Assume that CoMIs of all subsidiaries are in the same country, nevertheless the possibility of procedural consolidation may entirely disappear as long as subsidiaries are registered in different countries.\textsuperscript{363} Nonetheless, making a registered place more difficult to rebut as the indicator of insolvency jurisdiction may be a workable compromise.

After the analysis, the author is of the opinion that though in some limited cases forum shopping may provide benefits to creditors in general, one should be cautious about its possible negative influence. Chances of forum shopping under EIR recast are reduced. The next section will embark on analysis of CoMI and examine whether CoMI is a desirable jurisdiction rule to provide certainty and other benefit. A good understanding of forum shopping and CoMI together facilitate the later analysis of proposed cross-border insolvency law theories based on the group CoMI concept as a means of procedural consolidation.

\subsection*{3.3 Procedural significance of CoMI}

\subsubsection*{3.3.1 Theoretical underpinnings of CoMI}

In the field of cross-border insolvency law, there are mainly two rival theories governing the jurisdiction and choice of law of one multinational insolvency case: universalism and territorialism.\textsuperscript{364} Under both universalism and territorialism, the choice of forum will significantly determine the choice of insolvency law, as the court will apply its own

\footnotesize{\textsuperscript{363}Gerard McCormack, ‘Reconstructing European insolvency law-putting in place a new paradigm’ (2010) Legal Studies, Vol. 30 p135
\textsuperscript{364}See Chapter 4 for more details.}
This is an easy and low-cost way to bundle choice of forum and choice of law together. The reason is that insolvency law is to a large extent procedural law which is exclusively governed by the courts which enjoy jurisdiction; also, insolvency law stands for local values, which justifies applying the law where the insolvency proceedings are opened, i.e. *lex fori concursus*.

Territorialism allocates jurisdiction to any court that can grab debtors' assets in its territory, while universalism only allows the court in which the CoMI is located to open insolvency proceedings. Therefore, CoMI is a concept based on universalism theory. CoMI is defined as 'the place where the debtor conducts the administration of its interests on a regular basis and which is ascertainable by third parties.' It is presumed to be the registered place of one company. Nonetheless, such presumption could be rebutted by evidence proving that the real CoMI is in another jurisdiction.

To be more precise, the EU regulation is built up on a compromised form of universalism, which is called modified universalism. Under this theory, the jurisdiction to open main insolvency proceeding of one insolvent company is allocated to a court in which CoMI of the company is located. Compared to the conditions to open main insolvency proceedings, the courts where the non-transitory operations of that company are located could open secondary insolvency proceedings. This modification is to temper the universalism with the concern of local creditors' protection.

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365 New EU Regulation Article 7 the law applicable to insolvency proceedings and their effects shall be that of the Member State within the territory of which such proceedings are opened (the ‘State of the opening of proceedings’).
367 ibid p2
368 EIR recast 2015 Article 3(1)
369 EIR recast 2015 Article 3(1)
370 EIR recast 2015 Article 3(2) (Such operation should be being carrying out or has been carried out three months prior to the opening of the main insolvency proceedings.)
3.3.2 Evaluation of CoMI

3.3.2.1 Statutory definition of CoMI

Understanding the concept of CoMI is of significant importance, as CoMI directly decides which country's insolvency law will be applied to a company and whether the possibility exists that the CoMIs of a group of companies could be interpreted to be in the parent company's insolvency jurisdiction.

The first step is to discover what CoMI is for the EIR Recast purposes. The Virgós-Schmit Report, which provides the explanatory notes on the predecessor of EIR 2000, says that: 'Where companies and legal persons are concerned, the Convention presumes, unless proved to the contrary, that the debtor's centre of main interest is the place of its registered office. This place normally corresponds to the debtor's head office.' From this explanation, one may argue that great weight is given to the head office location when one determines the CoMI of companies.

In the previous version of EIR 2000, no precise definition of CoMI was provided. In EIR Recital 13, it provided that the 'center of main interest' should correspond to the place where the debtor conducts the administration of his interests on a regular basis and is therefore ascertainable by third parties; in Article 3(1), it says that 'in the case of a company or legal person, the place of the registered office shall be presumed to be the center of main interest in the absence of proof to the contrary.' However, there is no instruction about in which circumstance a registered place could be rebutted.

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371Virgós-Schmit report at para 75
372EIR 2000
373EIR recast 2015 Article 3(1)
Insolvency experts association Insol Europe defines CoMI as the operational head office of one company which is ascertainable to third parties.\textsuperscript{374} The definition emphasizes the place where the head office functions of companies are carried out rather than the place where the head office functions are formed. Corresponding to the EIR 2000, the requirement 'ascertainable to third party' is given considerable weight. Insol Europe also provided a list of factors as relevant determinants of CoMI.\textsuperscript{375} These factors count only if they are perceivable to third parties.

\textsuperscript{374} Revision of the European Insolvency Regulation Proposals by INSOL Europe 2012 p29

\textsuperscript{375} The most important factors to deduce the CoMI, inter alia, include:

- the location of the strategic, financial and operational management;

- the financial functions of the subsidiaries performed by the headquarters

(factoring agreement);

- financial information compiled in accordance with the requirements of the holding company (and not according to the requirements of each subsidiary);

- the subsidiaries’ inability to make purchases above a certain amount without the approval of their headquarters;

- cash management and pooling functions;

- the absence of budgeting autonomy;

- the recruitment of all senior employees of the subsidiary after consultation with headquarters;

- the appointment and removal of senior employees as performed by headquarters;

- all information technology and support as performed by headquarters;

- over 70\% of the purchases negotiated and dealt with by headquarters;

- the absence of independent trading by the subsidiaries; and

- branding, strategy and production design considerations.

Revision of the European Insolvency Regulation Proposals by INSOL Europe 2012 p32
In 2012 the European Commission also provided a proposal to amend EU regulation. Amongst other things, it provided CoMI definition as follows:

The 'centre of main interests' of a company or other legal person should be presumed to be at the place of its registered office. It should be possible to rebut this presumption if the company's central administration is located in another Member State than its registered office and a comprehensive assessment of all the relevant factors establishes, in a manner that is ascertainable by third parties, that the company’s actual centre of management and supervision and of the management of its interests is located in that other Member State. By contrast, it should not be possible to rebut the presumption where the bodies responsible for the management and supervision of a company are in the same place as its registered office and the management decisions are taken there in a manner ascertainable by third parties.\footnote{Proposal for a regulation of the European parliament and of the council amending council regulation(EC) No 1346/2000 on insolvency proceedings 2012/0360 (COD) recital 13(a) p16}

From this definition, the Commission agreed that the location where the head office functions are carried out, i.e. the location of the actual center of management and supervision is the location of CoMI.

The new EIR 2015 takes account of the development of the understanding of CoMI in recent years; in Article 3 of EIR recast, there is a definition provided as 'The centre of main interests shall be the place where the debtor conducts the administration of its interests on a regular basis and which is ascertainable by third parties; and 'the place of the registered office shall be presumed to be the centre of its main interests in the absence of proof to the contrary. That presumption shall only apply if the registered office has not
been moved to another Member State within the 3-month period prior to the request for the opening of insolvency proceedings.\textsuperscript{377}

Two recitals also help to further explain the mechanics of CoMI. Recital 28\textsuperscript{378} immutably emphasizes the importance of the 'ascertainable to third parties' requirement of CoMI; it further provides an example whereby if there is a shift of CoMI, proper notice should be given to creditors. Also, recital 30\textsuperscript{379} imposes obligations on member states to carefully examine whether the CoMI is indeed in their territory before opening proceedings.

From the statutory definition of CoMI, one could argue that CoMI is presumed to be the register place of one company. This presumption provides the most predictable result for the third party to check and confirm the location of CoMI for one specific company. The presumption can be rebutted only when the evidence appears that the real head office functions are carried out from another member state and it is ascertainable to the third parties. Where the head office functions location and registered place are in the same place and could be ascertainable to third parties, the CoMI place cannot be challenged. Where the central administration and the registered place are in two different places, a comprehensive assessment of all factors needs to be conducted so as to determine the real CoMI. In either case, relevant factors used for analysis and the purported central administration need to be ascertainable to the public.

\textsuperscript{377} EIR recast Article 3
\textsuperscript{378} EIR recast recital 28 'special consideration should be given to the creditors and to their perception as to where a debtor conducts the administration of its interests. This may require, in the event of a shift of centre of main interests, informing creditors of the new location from which the debtor is carrying out its activities in due course, for example by drawing attention to the change of address in commercial correspondence, or by making the new location public through other appropriate means.'
\textsuperscript{379} Recital 30 'Member State should carefully assess whether the centre of the debtor's main interests is genuinely located in that Member State. In the case of a company, it should be possible to rebut this presumption where the company's central administration is located in a Member State other than that of its registered office, and where a comprehensive assessment of all the relevant factors establishes, in a manner that is ascertainable by third parties, that the company's actual centre of management and supervision and of the management of its interests is located in that other Member State.'
The CoMI of one company is, in many cases, likely to be in the same place as its registered place. It is sensible to attach great importance to registered place by making it difficult to be rebutted, due to the need for predictability. Except where the company does almost no business in its registered place, the presumption can be rebutted. It is correct for the EIR to respect creditors' perception for the purpose of certainty, but this approach relies on creditors' subjective reliance. A better way to fix such drawback is to increase the difficulty of rebutting the presumption. The next section moves to the case law and examines how case law shapes the definition of CoMI.

3.3.2.2 CoMI in case law

The development of the concept of CoMI is largely fuelled by certain important cases both at national level and EU level. This section aims to provide an overview of relevant important cases. Case law provides certain clarity and flexibility on CoMI and some of the cases are tailored to accommodate corporate group insolvency.

3.3.2.2.1 Daisytek ISA

As cross-border insolvency law respects the legal person status of every company, it may be difficult for the groups of companies registered in different countries to come to one court to open insolvency proceedings. That is to say, the procedural consolidation of insolvency proceedings is not provided by the EIR 2000 or EIR 2015. The Daisytek

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382 Luci Mitchell-Fry and Sarah Lawson, ‘Defining CoMI, where are we now.’ (2012) Corporate Rescue and Insolvency, p17
case opened an innovative way to deal with the cross-border insolvency of corporate groups. Daisytek ISA is itself a subsidiary of a US-based parent company-Daisytek, while it is also the holding company of sixteen European subsidiaries in the group in Europe. Daisytek ISA registered in the UK with its CoMI in the UK as well. When the European sub-group became insolvent, many petitions for administration were made in the English court. The core issue of this case is whether the court of England has jurisdiction to make administration orders for those foreign subsidiaries.

The UK court noted that the key to open insolvency proceeding for foreign registered subsidiaries was to rebut the Art.3(1) of the EIR 2000, i.e. the UK court needed to be convinced that the CoMIs of these subsidiaries are in the UK, not at their respective registered countries. After considering the scale and importance of the interests of creditors of subsidiaries, the court confirmed that the UK was the place of CoMI of the European group.

After an analysis of CoMI for all the subsidiaries, the UK court believed that the actual CoMIs of all the subsidiaries were in the UK, so the court was entitled to open insolvency proceedings on behalf of the whole group. Though the UK court did not create the concept of 'group CoMI', it indeed provided an innovative interpretation of CoMI whereby the subsidiaries in other member states could be drawn to the UK to open insolvency proceedings, based on article 3(1) of the EU regulation.


\[385\] The factors to support such a reasoning were: 'financing of the business is from UK; 70% goods supply contracts made in UK; German subsidiary needs approval from UK if spending exceeding 5000 Euros or recruitment of senior employees; also, technology and support are from UK, pan-European customers contracted and negotiated with UK holding company, which comprise 15% sale amount of German subsidiary.' Re Daisytek-ISA Ltd [2004] B.P.I.R. 30.
Such innovation did not come without resistance from foreign courts, while the general attitude to this new way was supported later on the basis that UK courts had conducted detailed analysis of the location of CoMI for every subsidiary rather than rubber-stamp the insolvency petitions. These challenges of foreign courts could be partly understood as issues of communication between courts, as the French and German courts may not have been fully aware of the reasoning of the UK court. Nonetheless, one could also argue that the foreign courts may be reluctant to give up cases to the UK court.

Innovative procedural consolidation may be used in limited circumstances, as its uncertainty may upset the foreign creditors and foreign courts.

The innovation of the UK court nevertheless is applaudable in that it provided a way to deal with corporate group insolvency under the old framework where no helpful regimes assist the court to do so. Nevertheless, we should not ignore the danger lying in this approach. One should not assume all the courts could seize jurisdiction appropriately with the conduct of correct CoMI analysis under the EIR.

3.3.2.2 Eurofood

The approach taken by the UK court in the Daisytek case took issue with the Eurofood case decision made later by the ECJ. The Eurofood case was an important ECJ case.

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386 The French commercial court argued that the UK court ignored the fact that CoMI did not apply to corporate group context; besides it, the commercial court believed the CoMI is in the France while UK only possessed one establishment of this company. It is wrong for UK court to open main insolvency proceeding against French registered subsidiaries.

387 French court decision later was repealed by the court of appeal of Versailles as the latter believed that the UK court had conducted the CoMI analysis. German courts also supported the UK court. Hon. Samuel L. Bufford, 'International insolvency case venue in the European Union: the Parmalat and Daisytek controversies' (2005-2006) 12 Colum. J. Eur. L. 429 p460

388 Some foreign courts may not be aware of the UK court had opened insolvency proceedings firstly, nor were they aware of how the UK court decided the CoMI. As a result, concerns regarding whether the UK court had done it in a proper way arisen.


390 ibid p369

391 In re Eurofood IFSC Ltd [2006] Ch. 508
emphasising that CoMI should be decided on an entity basis while not on a group of companies basis.

Eurofood was a wholly owned subsidiary of an Italian parent company in Parmalat group. The registered place of the Eurofood was in the Ireland throughout its existence. One feature of Eurofood worth mentioning was that it was a finance company which did not hire any employees; it only made three transactions during its existence for the corporate group, two for operations in South American, and one for operation in Ireland.\(^\text{392}\) Also, it held the certificate of the Ministry of Finance of Ireland so as to stay in international finance service center to take advantage of tax benefit.\(^\text{393}\) Any change with regard to the management or location of Eurofood needed a decision from Ministry of Finance.\(^\text{394}\) Its business was empowered to the Bank of America. All these evidences showed that the CoMI of Eurofood was in Ireland and it was ascertainable to its creditor, the Bank of America. On the entity law basis, one could argue that the center of gravity of Eurofood was in Ireland.

However, the Italian court believed the CoMI of Eurofood should be in Italy, where its parent company was located. Similar to the reasoning from the Daisytek case, the Italian court argued that Eurofood was incorporated in Ireland for tax benefits and was only the financial division of the whole Parmalat Group; all it did is to implement the decisions made by the parent company.\(^\text{395}\) Furthermore, the creditors of Eurofood would have no


\(^{395}\) ibid p368
difficulties knowing that Eurofood was an ‘empty box’ and its parent company was in Italy.  

The Irish court retorted that the Italian court was not aware of the fact that the creditors of Eurofood actually believed that the CoMI of Eurofood was in Ireland, as their investment in Eurofood was subject to Irish fiscal regulation.  

After the Italian court referred to the ECJ for instruction, the ECJ held: 'the ECJ notified that the EIR did not apply to groups of companies and the relationships amongst them thereof; the ex ante predictability, especially of the cross-border debt transaction was very important to the interests of creditors. When deciding the CoMI of one specific company, the ECJ considered factors relating to registered place, place of head office functions and ascertainable to third parties; the ECJ also considered factors of location of parent company and the control it could exert on the decision-making of subsidiaries. And then it reasoned: 

'… only if factors which are both objective and ascertainable by third parties enable it to be established that an actual situation existed which was different from that which locating it at that registered office was deemed to reflect. Where a company carried on its business in the member state where its registered office was situated, the mere fact that its economic choices were or could be controlled by a parent company in another member state was not enough to rebut the presumption;'.

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398 ibid p381
399 Eurofood [2006] Ch.508 Held(1) P3.
‘The fact (assumed by the referring court) that the subsidiary conducts the administration of its interests on a regular basis in a manner ascertainable by third parties and in complete and regular respect for its own corporate identity in the member state where its registered office is situated will normally be decisive in determining the “centre of [its] main interests.”

The ECJ finally decided that as the registered place and CoMI were in Ireland and ascertainable to creditors, the Irish court should have jurisdiction.

The Eurofood case effectively challenged the validity of the practice from Daisytek. It argued that simply being able to exert control on subsidiaries from a parent company is not adequate to determine that the subsidiaries’ CoMI is in the place where the parent's CoMI is located.

As a result, every company's CoMI has to be determined in an entity-by-entity manner. This indicates that the relationship between parent and subsidiaries should not directly affect the location of the CoMIs of subsidiaries. The court also concluded that in the case where parent and subsidiaries are registered in different member states, the subsidiary operating its business in its own identity in the registered place on the regular basis and ascertainable to third parties is an enough condition to determine its CoMI. Conversely, if the control executed by the parent company is not ascertainable to the third parties, the presumption that the subsidiary's CoMI is in its own registered place cannot be rebutted simply on the basis that the parent company could wield its power to appoint board of directors and affect the decision of the subsidiaries.
The Eurofood case is considered to be a new stage of development of CoMI in that the registered place become harder to be rebutted simply by a parent-subsidiary relationship. Nevertheless, the Eurofood case does not completely eradicate the possibility that the CoMI of the parent company is also the CoMI of all group members. If the subsidiaries' CoMIs are indeed in their parent's location and are ascertainable to third parties, relevant insolvency proceedings of subsidiaries still could be opened in the place of the parent company. Therefore, it could be argued that there may not be serious contradictions between the Eurofood case and the Daisytek case. This is because in the Daisytek case the court did not simply locate the CoMI of each subsidiary to England on the sole basis of their parent-subsidiary relationship. The court, by analysis of all relevant factors of central administration of each member, decided the CoMI of subsidiaries.

3.3.2.2.3 MPOTEK

After the Eurofood case, the MPOTEK case showed that the pragmatic approach to allocating jurisdiction of subsidiaries to one country is still available in certain cases where business integration is close and subsidiaries are centrally controlled.

MPOTEK, as a subsidiary of the French Emtek group, had its registered place in Germany. While the presumption of registered place indicated that Germany should be the insolvency jurisdiction, the application for administration was delivered to the French Commercial Court of Nanterre. The whole group is business-integrated. For example, one subsidiary controls human resources, management and development of strategy, while the another is in charge of commercial policy, supermarket distribution, and

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406 MPOTEC GmbH[2006] B.C.C. 681
407 ibid p1
management of purchases of merchandise. The French court reasoned that the head office functions of MPOTEK are in France and ascertainable to third parties, so that the court has jurisdiction to open insolvency proceeding for MPOTEK. As a result, the insolvency proceedings are held in France so that a cross-country reorganisation rescue became possible. The value of the group in the trade mark and distribution network could be retained.

One important point to bear in mind is that the French court did not seize jurisdiction purely on the basis of the integrated business characteristics of the group. Rather, it analysed the CoMI of MPOTEK subsidiary according to ‘head office functions’ and ‘ascertainable to third party’ tests. The special feature of the Emtek group is that other subsidiaries except MPOTEK consisting of the integrated business network are based in France. If they are in different countries, the result of the case may be changed. Since each subsidiary controls certain head office functions ascertainable to third parties, it is difficult to allocate all of jurisdictions to French court.

3.3.2.2.4 Standford

In the leading UK case Re Standford International Bank Ltd, Lewison J stressed the importance of certainty of CoMI. CoMI is a fact-oriented concept in the sense that it is built on the basis of objective factors. CoMI is the head office function of one company determined on the basis of objectivity and ascertainability. In the Standford case, the court of appeal agreed with Lewison J, and confirmed that it is important to consider whether the factors determining head office functions are ascertainable to the third parties. The EIR does not only aim to allocate the jurisdiction to the court which possesses the actual CoMI, rather, it also aims to ensure it could be perceived by third parties.

408 ibid p4
409 ibid p2
410 ibid p2
411 Re Stanford [2010] EWCA Civ 137
412 Luci Mitchell-Fry, Sarah Lawson, ‘Defining CoMI, where are we now.’ (2012) Corporate Rescue and Insolvency, p16
Perception is closely related to predictability, which is an important requirement for creditors to calculate risks.\textsuperscript{413} The ascertainable to third party test ensures that all the necessary information to decide the location of CoMI is in the public domain.

### 3.3.2.2.5 Interedil case

The Interedil case is another influential ECJ case on the definition of CoMI. The company Interedil is an Italian company registered in the Italy. In July 2001, it was registered in London as a foreign company and on the same day it removed its registered office from the Italian Register Office.\textsuperscript{414}

The dispute regarding jurisdiction of Interedil started on October 28, 2003. On that day, an Italian creditor Intesa filed an insolvency proceeding against Interedil in Italy. However, the Interedil company argued that since the register office had been transferred to the UK, the Italian court should not have jurisdiction as the registered place was assumed to the be the CoMI.\textsuperscript{415} The Italian court disagreed and believed the CoMI was in the Italy as Interedil still owned real estate, bank accounts and a leased hotel in Italy.\textsuperscript{416} Italian court also argued that Interedil, after transfer of register place, did not carry out any transactions, so the central administration was not transferred.\textsuperscript{417}

The ECJ refereed to the judgment of the Eurofood case and rendered the opinion that central administration of one company is the decisive factor for the purpose of

\textsuperscript{413}In re Stanford International Bank Ltd and another[2010] Bus. L.R. 1270 p21
\textsuperscript{415}Interedil case [2012] B.C.C. 851P2
\textsuperscript{417}Opinion of advocate general kokott delivered on 10 March 2011 para55
determination of CoMI. The factors assessed should be objective and ascertainable to the creditors.\textsuperscript{418} The ECJ went on to provide that where the registered place and ‘management and supervision place’ are in the same place and ascertainable to third parties, the CoMI cannot be rebutted; where they are in different places, the mere fact that one country possess assets and contracts is not sufficient to determine CoMI; a comprehensive assessment of all the relevant factors is needed so as to prove central administration that is ascertainable to third parties is in the state.\textsuperscript{419}

Two parts of the court judgment are worth particular attention. One is that the ECJ used the words ‘management and supervision place’ of one company as a representation of CoMI.\textsuperscript{420} This leads some scholars to argue that Interedil case narrowed the factors to determine the CoMI.\textsuperscript{421} If this is true, the approach may facilitate the corporate group insolvency, as it enables the court to seize the jurisdiction if it can show that the management and supervision place of the entire EU-wide group or European sub-group of a US corporate group is in its territory.\textsuperscript{422} This interpretation nonetheless may ignore the fact that the Interedil reasoning does not mean to deviate from Eurofood.\textsuperscript{423} Putting it in the context of the case, the court required a comprehensive assessment of all the objective factors ascertainable to the third parties to determine CoMI, so that only considering the place of nominal head office is not sufficient. Moreover, the location of management and supervision should only be ascertained after considering all the objective factors which

\textsuperscript{418}Interedil Srl (in liquidation) v Fallimen to InteredilSrl and another [2012] Bus. L.R. 1582 p2
\textsuperscript{419}Interedil case [2012] B.C.C. 851 P3
\textsuperscript{420}‘Group insolvency - forum - EC Regulation and model law under the influence of English pragmatism revisited’ (2014) 9 Brook. J. Corp. Fin. & Com. L. 179 p4
\textsuperscript{421}Thomas Biermeyer, ‘Case C-396/09 Interedil Srl, Judgment of the Court of 20 October 2011, not yet reported Court guidance as to the COMI concept in cross-border insolvency proceedings’ 18 MJ 4 2011 p587
\textsuperscript{422}‘Group insolvency - forum - EC Regulation and model law under the influence of English pragmatism revisited’ (2014) 9 Brook. J. Corp. Fin. & Com. L. 179 p5
\textsuperscript{423}Adrian Cohen, ‘Eurofood for thought: additional guidance on COMI’ (2012) 1 JIBFL 52 p3
are ascertainable to the third parties; that is to say, management and supervision is the result of the analysis, rather than an independent factor to determine CoMI.

Another part is that the court gave more weight to ‘ascertainable to third party’ test of CoMI. This is understandable, because one important goal of insolvency is certainty as mentioned in Chapter 2. So the creditors should enjoy the right to know beforehand which jurisdiction’s law they are going to deal with; and how rights are going to be affected under a specific law. So the location of CoMI should be decided in line with what creditors understand. Some scholars, from the viewpoint of the ECJ in Interedil case, argue that creditors may have inclination to believe the place of operational factories rather than the place of management and supervision is the location of CoMI. That is to say, creditors’ perception may be subjective and therefore different to the reality. However, after careful analysis of the Eurofood and Interedil cases, one may argue that creditors’ perception should not be based on their respective subjective views. Rather, they should predict the location of CoMI on the basis of objective factors available in the public domain. Therefore, such test is still an independent and objective test. After processing all the relevant objective factors, most of creditors will reach the same conclusion of the location of CoMI of a given debtor. Any hidden information known only by sophisticated creditors or debtors is excluded from consideration.

425 ibid p2
426 ibid p3
427 Luci Mitchell-Fry and Sarah Lawson Defining COMI: where are we now? February 2012 Corporate Rescue and Insolvency p17
3.3.3 Certainty of CoMI

Insolvency law relates to lending interest rate which is expected to be ex ante predictable. In cross-border insolvency context, which set of insolvency laws will be applied to a given case is determined by insolvency jurisdiction rules. CoMI, as a jurisdiction rule, assigns insolvency proceedings to the court of CoMI irrespective where the debtors do businesses. This choice of forum rule generates predictability and uniformity. Nevertheless, the concept of CoMI could be criticized as not being clear enough; this is especially true in the context where the main assets and operations of the companies are not in the same place.

As CoMI also needs to be ascertainable to the third parties, the importance of the place of decision-making seems therefore to be subordinate to importance of the place where the decision-making is being carried out, i.e., the place of operation. That is because the creditors arguably are more likely to identify the objective operation places than to identify the subjective and abstract decision-making places. However, it is possible that certain senior creditors, such as banks that play monitoring roles may more readily ascertain the real decision-making location of one given company. This begs the question of whose expectation needs to be served in terms of the requirement of 'ascertainable to third party'. The solution seems to require the debtors to disclose as much information as possible to the public so that creditors in general can roughly make the same conclusion.

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429 The choice of law theory of CoMI is based on multilateralism theory which analyses the connection between legal relationship and one court; thereafter, the theory assigns the legal relationship to one court, which arguably generates predictability and uniformity, see Hannah, L. Buxbaum, 'Rethinking international insolvency: the neglected role of choice of law rules and theory' (2000) 36 Stan. J. Int'l L. 23 p39, p60
432 André J. Berends, 'The Eurofood case: one company, two main insolvency proceedings: which one is the real one' (2006) NILR p345
regarding the place of CoMI.

One may also notice the difficulties of fixing the above problem if the elements making up the CoMI could not be defined, as different industries may comprise different important elements which affect the determination of the location of the CoMI. ⁴³³ The development of case law tries to enhance the objectivity of CoMI by providing that CoMI should be decided by objective factors which are ascertainable to third parties. Though this requirement may help to depict the frame of the CoMI, in practice creditors may still have different views as they perceive different facts. Therefore, case law so far does not provide a highly predictable CoMI concept.

To replace the CoMI with a registered place may obtain the benefits of increasing predictability, but this way is not perfect when dealing with letterbox companies. ⁴³⁴ As insolvency law reflects one country’s social policies and priority of values, it is not justifiable to replace the insolvency policies of the country which has most stake in the risk with the ones of the countries of letterbox companies. Also, such change of EIR may create inconsistency of the CoMI test, as the UNCITRAL Model law also uses the CoMI concept. ⁴³⁵ Therefore, increasing the threshold to rebut the registered place presumption may be a better way. The workable direction of development of CoMI is by means of provisions and cases which could enhance its predictability. For example, Recital 32 of the EU regulation provides that where debtor’s opinion with regard to the location of CoMI causes doubt, debtors may need to provide further evidence, and creditors are also given opportunities to express their opinions. ⁴³⁶

⁴³³Ibid p338
⁴³⁴Gerard McCormack, ‘Something Old, Something New: Recasting the European Insolvency Regulation’ (2016) 79(1) MLR, p130
⁴³⁵Ibid p130
⁴³⁶Ibid p131
Another merit of the rule keeping the CoMI as the jurisdiction is its relatively unbiased function regarding jurisdiction allocation. If CoMI is interpreted as simply the head office, it generally works in the interest of more developed countries such as the UK than of less developed countries, even though the operations are in the territory of the latter. Since it is more likely that the head office of one company is located in the more developed location such as London, the UK may more frequently seize jurisdiction than other foreign courts. Adopting 'group CoMI' for cross-border insolvency of MCGs will further exaggerate the uneven allocation of insolvency proceedings.

3.4 Evaluation of territorialism and universalism

With the understanding of concept of CoMI, now it is possible to evaluate territorialism and universalism in terms of their abilities regarding preservation of going concern value and certainty.

3.4.1 Ability to preserve value

Territorialism may not be able to preserve going concern value for a single company, let alone MCGs. It ignores the economic reality of international business, as it allows borders of countries to sever the business which would have been one integrated part. Such weakness of territorialism exists in cooperative territorialism as well. Though it is possible that an agreement will be achieved by creditors scattered in different member states, it is also possible that no consensus could be achieved if it is harmful to certain local creditors. Also, the cooperation under cooperative territorialism may be

438 ibid p199
disorganized due to the fact that there is no leading court to coordinate the whole process. It is desirable to have one leading court, taking into account other courts’ opinions, to propose a reorganization plan such that a well-functioning and effective group reorganization plan can be achieved.\textsuperscript{440}

One may argue that territorialism may reduce costs as it is convenient for the local creditors to lodge debtors locally. However, such advantage is faded as the new EU regulation recast Article 45 provides that insolvency practitioners may help creditors to lodge claims in every opened insolvency proceeding.\textsuperscript{441} With the support of representatives, the cost to local creditors to lodge claims in foreign courts will be reduced.

In the typical universalism paradigm, one representative or trustee of an insolvency case could be entrusted to communicate with all the creditors; one single set of insolvency law, which is the law of the opening state will be applied to the whole case wherever creditors are located. Therefore, territorialism is very likely to be more inefficient than universalism in the sense that it increases the information cost of adjusting creditors.\textsuperscript{442} The same result is true for non-adjusting creditors, as under universalism they may be able to collect information regarding foreign bankruptcy regimes at a low cost.

\textsuperscript{440}External evaluation of regulation no. 1346/2000/EC on insolvency proceedings p234; example is illustrated by the new regulation article 61 group coordination proceeding and article saying that 70 the court opens coordination proceeding have right to produce group coordination plan.
\textsuperscript{441}EU regulation on insolvency proceedings recast, Art.45.
\textsuperscript{442} Adjusting creditors defined by the Andrew Guzman as the creditors who can and will adjust their interest rate in terms of risks of lending; by contrast, none-adjusting creditors are the ones who will not or cannot adjust interest rates either due to the high cost involved (such as credit card companies which generally charge a same rate to everyone) or inability to adjust interest rates (tort creditors or tax authorities).
compared with collecting information of every creditor under territorialism; only dealing with one country may allow non-adjusting creditors to decide interest rates.\textsuperscript{443}

Universalism also avoids multiple insolvency proceedings being opened against the same debtor, so administration fees and cooperation costs can be reduced.\textsuperscript{444} One court with one set of insolvency rules makes a cross-border sale or rescue achieved quickly. As a result, pure universalism, by reducing the international transaction cost\textsuperscript{445}, (especially the debt collection cost), achieves the goal of maximization of value. Modified universalism may be criticized as it allows more than one proceeding to open.\textsuperscript{446} Nevertheless, modified universalism does not necessarily mean that secondary proceedings have to be opened. Re MG Rover Espana SA case\textsuperscript{447} exemplifies such situation.

In this case, the English court appointed joint administrators on behalf of eight foreign national sales companies in Europe. An issue was that the local employees might have been treated less favourably by the English insolvency law, which would have given rise to secondary proceedings.\textsuperscript{448} The English court and joint administrators were of the opinion that the purpose of administration of MG Rover group was to rescue it as a going concern and preserve its distribution networks; the English court believed that the administrators could make certain payments to local employee creditors under their own local law.\textsuperscript{449}

\textsuperscript{445} Edward s Adams, Jason k. Fincke ‘Coordinating cross-border bankruptcy: how territorialism saves universaliSm’ (2008-2009) 15 Colum.J.Eur. l.43 p49
\textsuperscript{446} ibid p55
\textsuperscript{447} Re MG Rover Espana SA[2006] B.C.C. 599
\textsuperscript{448} ibid p3
\textsuperscript{449} Without taking into account the local creditors’ interests, the secondary proceedings may be inevitably opened and it would make the rescue of the group unable to do. The English courts believed that it was correct to interpret para.66. of Sch.B1 of insolvency law act 1986 as that the administrators have power to
Even though secondary proceedings are opened, modified universalism may not lead to a large number of multiple insolvency proceedings as cooperative territorialism does. As opposed to the low threshold to open jurisdiction in territorialism, there is a relatively high threshold to open secondary proceedings, namely establishment test.\textsuperscript{450} In the case of Olympic Airline, the courts reasoned that: \textit{‘the existence of an establishment must be determined, in the same way as the location of the centre of main interests, on the basis of objective factors which are ascertainable by third parties.’}\textsuperscript{451} Also, a winding-up proceeding alone does not meet the establishment threshold.\textsuperscript{452} Furthermore, the mere existence of an office or branch is not enough to convince a court that the debtor has an establishment; it should be a real operation involving human resources and assets.\textsuperscript{453} To meet the establishment test, the business should be conducted in a fixed place, while it should deal with the third parties in the market.\textsuperscript{454}

Secondary proceedings could be utilized as a cost-effective tool to resolve local complex issues by advantageous local law.\textsuperscript{455} Also, certain EU regulation provisions can be used to reduce the number of them.\textsuperscript{456} To sum up, universalism can preserve going concern value make payment for the purpose of achieve the goals of administration, even such payment is not consistent with the rank of insolvency law, the administrator themselves need to think about whether such payment to avoid secondary proceeding can exchange for a better result.\textsuperscript{Re MG Rover Espana SA [2006] B.C.C. 599 p6}

\textsuperscript{450} Under territorialism, one court could open insolvency proceedings as long as it possesses assets of the debtor; EU regulation only allows local courts to open secondary proceeding if they possess establishment of the debtor. According to EU regulation art. 2 (10)‘establishment’ means any place of operations where a debtor carries out or has carried out in the 3-month period prior to the request to open main insolvency proceedings a non-transitory economic activity with human means and assets;

\textsuperscript{455} Trustees of the Olympic Airlines SA Pension & Life Assurance Scheme v Olympic Airlines SA [2015] UKSC 27 p6

\textsuperscript{456} Ronan McNabb \textit{‘Olympic airlines: A first step to tighter controls in secondary proceedings?’} (2013)

Corporative rescue and insolvency p130

\textsuperscript{455} Trustees of the Olympic Airlines SA Pension & Life Assurance Scheme v Olympic Airlines SA [2013] EWCA Civ 643

\textsuperscript{456} Trustees of the Olympic Airlines SA Pension & Life Assurance Scheme v Olympic Airlines SA [2015] UKSC 27 p6

\textsuperscript{456} Ian Fletcher, \textit{Insolvency in private international law} (2nd Edition OUP Oxford 2005) p432

\textsuperscript{456} Recital 42 EU regulation ‘…this Regulation confers on the insolvency practitioner in main insolvency proceedings the possibility of giving an undertaking to local creditors that they will be treated as if secondary insolvency proceedings had been opened. That undertaking has to meet a number of conditions set out in this Regulation, in particular that it be approved by a qualified majority of local creditors. Where
better than territorialism.

3.4.2 Certainty-forum shopping

Certain advocates of territorialism argue that territorialism yields a higher level of predictability than does universalism.\(^{457}\) Though assets may be transferred from one jurisdiction to another, even at the vicinity of the insolvency proceedings, defenders for territorialism assert that the effect of such transfer is only limited to the assets being transferred; also, the local creditors could file their claims in the country to which the assets are transferred to require distribution in that insolvency proceeding.\(^{458}\)

As with forum shopping in territorialism, CoMI can also be manipulated under universalism for the purpose of forum shopping.\(^{459}\) Universalism assigns jurisdiction to CoMI, which is unchanged no matter how are assets relocated.\(^{460}\) Transferring assets is easier than transferring CoMI, so moving assets is more easily manipulated in this regard. Also, if the local creditors’ priority is not recognized in the foreign courts, local creditors are unlikely to recover their losses by filing their claims in those courts. This is probably the main reasons why certain creditors or debtors initiate such a transfer of assets in the first place.

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When debtors transfer assets from one member state to another at the eve of the insolvency, creditors in different member states do not need to worry about the location of assets as the court possessing CoMI will govern the case. Territorialism makes non-adjusting creditors even worse off due to the manipulation. The information cost for adjusting creditors is very high, as they have to ascertain a number of factors regarding the location of assets and the priority of creditors in different jurisdiction. Also, as it is difficult to predict the chances of transfer of assets, the adjusting creditors can hardly fully adjust their interest rates. This leads to inefficient results as the interest rates will increase.461

Also, universalism prevents unfair situations where the some creditors receive nothing just because they are in the member state that possesses no assets. As moving assets is easier than moving CoMI, so universalism generally is more predictable462 than territorialism by providing a uniform way to select jurisdiction.

Another reason why territorialism provides higher predictability than rival regimes is because local creditors may expect local law to be applied to them.463 Therefore, territorialism may be adopted with modest friction from member states.464 This assumption may ignore the fact that the categories of creditors are highly diverse; among them, there are sophisticated creditors who do not base their expectations on local insolvency law and local assets as the only resources of assets of debtors. For example,

462 See Ulrik Rammeskow Bang-Pederse, ‘Assets distribution in transnational insolvencies, combining predictability and protection of local interests’73 Am. Bankr. L.J. 385 (1999) which argues that universalism with cross priority is a better principle with regard to predictability and local creditors protection than different forms of territorialism.
464 Hannah I Buxbaum, ‘Rethinking international insolvency: the neglected role of choice of law role and theory’.(2004) Indian University p26

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certain banks enjoy cross-guarantee from all the subsidiaries in corporate groups.\textsuperscript{465} Also, not all the local creditors are offered priority by the local law so that they may not have to be protected under local law. More importantly, protecting local creditors by local assets may either make local creditors receive a windfall where the assets/claims rate is high, or make them suffer where the rate is low. By contrast, under universalism, the creditors generally enjoy rights to file their claims in other countries, and they may be given priority under foreign insolvency law. As a result, the local creditors in many cases can be better protected.

The incentive for forum shopping under modified universalism is not as strong as that in universalism due to the possibility to open secondary proceedings.\textsuperscript{466} One may criticize that the conditions to open secondary proceedings is not entirely clear.\textsuperscript{467} Courts may decide to open secondary proceedings or dismiss the application at their discretion. However, this argument should not be overstated. One reason is that secondary proceedings may not even be commenced in many cases. This is especially true in the cases where the local creditors and courts are happy to defer to the main proceeding either because local creditors’ rights are respected or because certain compensation is made to local creditors under local law. Also, as in the case of Public Prosecutor v Segard shows, under EU regulation and the development of case law, common principles are built up. The French court requested the French court of appeal to ignore UK judgement by invoking public interest, as it argued that the UK court did not protect French employees by allowing them to be represented in court.\textsuperscript{469}

\textsuperscript{467}Hannah I Buxbaum ‘Rethinking international insolvency: the neglected role of choice of law role and theory’. (2004) Indiana University p30
\textsuperscript{468}Public Prosecutor v Segard [2006] (As Administrator for Rover France SAS) I.L.Pr. 32 p8
\textsuperscript{469}ibid p8
However, the French court of appeal was of the opinion that though Article 26 of EU regulation confers member states the right to refuse foreign main proceedings on the basis of public policy provision, the grounds to apply it should be limited to the minimum necessary.\(^{470}\) The English court’s arrangement neither deprived French employee’s rights, nor prevented them from claiming their preference; also the consultation of the workers' council and staff representatives was also conducted by the English administrator under French employment law; the opening of secondary proceedings should be purposeful and bring benefits to creditors but in this case there was no reason to open it.\(^{471}\)

One aim of secondary proceedings is to cooperate with main proceedings to achieve a good reorganization result for creditors, rather than to act against main proceedings. Therefore, member states may not allow secondary proceedings to be opened without any meaningful reasons, even though local applicants would like to do so. Therefore, in cases where the courts find that the opening of secondary proceeding is of no utility, they may reject the application.

**Summary**

Territorialism has drawbacks in two aspects: high cost and low predictability. Multiple insolvency proceedings make territorialism costly; the unpredictability gives rise to inefficient strategic behaviours, such as forum shopping by moving assets.\(^{472}\) Cooperative territorialism does not make such cooperation mandatory as EIR does. Another problem is that it makes value preservation difficult to achieve, for example by selling businesses as

\(^{470}\) ibid p8

\(^{471}\) Public Prosecutor v Segard [2006] (As Administrator for Rover France SAS) I.L.Pr. 32 p2

Cooperative territorialism may not do better than modified universalism in cases of MCGs reorganization.\textsuperscript{474} A desirable cross-border insolvency theory should respect economic reality of international businesses and provide mechanisms to encourage cooperation or even deference between courts and insolvency practitioners in order to preserve going concern value and yield predictability. Universalism based on CoMI as the insolvency jurisdiction rule has considerable advantages. The next section will further examine whether CoMI could be applied to MCGs, i.e. group CoMI.

### 3.5 Puzzles of group CoMI

3.5.1 Definition of group CoMI

One may consider whether one given MNC can have a joint group CoMI so that one court could deal with the cross-border insolvency of the entire group. More complexity may be introduced by MCGs in terms of assessing the CoMI for a whole group of companies. EIR recast does not provide the concept of group CoMI. Also, following the Eurofood case tenet, it is the attitude of the ECJ that corporate groups should be treated in an entity-by-entity fashion.

However, there are good reasons to consider the concept of group CoMI: procedural consolidation. The benefits of centralizing insolvency proceedings of group members into one jurisdiction (in most cases, the parent’s jurisdiction) have long been recognized.

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{473} Jay Lawrence Westbrook, ‘Multinational Financial Distress: The Last Hurrah of Territorialism’ (2013) Texas international law journal Vol. 41(321) p333
\item \textsuperscript{474} ibid p334
\end{itemize}
\end{footnotesize}
Some scholars have tried to provide a group CoMI concept for the insolvency of corporate groups. The main reason to employ this concept is to centrally control the insolvency proceedings and to maximize the recovery of corporate group insolvency for creditors due to the higher likelihood of successful insolvency reorganization.

It is correct to note that modern global business may be conducted in a cross-division way in the corporate group rather than in an entity-by-entity way. That is to say that the business integration of group members may not be served well by traditional insolvency law, especially in corporate rescue situations.

One may therefore argue that it is desirable to have provisions in the EIR to allow one court to open insolvency proceedings for all group members if it is clear that the whole group is run as one entity. Under this situation, one court could administer the group insolvency without the need to design new provisions specific for group insolvency.

The group CoMI concept helps to centralize insolvency proceedings in one place, especially in terms of the types of corporate groups which are business-integrated and centrally controlled by one parent company. Such conduct will reduce the cost of multiple insolvency proceedings and avoid the difficulty of court-to-court cooperation. Just as CoMI is the place where the head office functions are carried out, the same may apply to corporate groups, i.e. the place where the head office function is centrally carried out and controlled.

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475 For example, Professor Irit Mevorach and Samuel Bufford
478 ibid p5
480 ibid p8
Some scholars also endorsed the necessity to introduce a group CoMI concept, so that the court possessing group CoMI could have jurisdiction to open insolvency proceedings for all the group members. One may suggest that the group CoMI concept could free-ride the development of CoMI, and group CoMI can be defined as the location where the group collectively organizes and manages its interests and is perceptible to third parties. Such a place corresponds to the place where the group’s actual head office functions are carried out.

Another scholar’s proposal—virtual territoriality also suggests a group CoMI to regulate corporate group insolvency. Professor Janger believes that corporate groups insolvency proceedings could be centralized in the group CoMI jurisdiction. While the court possessing group CoMI could decide whether to open secondary proceedings, it should apply the law of subsidiaries’ CoMI to each group member. In other words, the court of group CoMI should only control the multiple insolvency proceedings with regard to administrative or procedural matters, while leaving the substantive insolvency issues to the law of subsidiaries’ home countries. The effect is that though only one court governs the group's insolvency cases, the creditors of subsidiaries are treated as if subsidiaries’ insolvency proceedings are opened in its own countries. Such a decentralized choice of law practice may better be implemented in business-integrated, centrally-controlled corporate groups context, otherwise it may create unjustified disturbance to the sovereignty of subsidiaries’ countries.

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482 ibid p716
483 ibid p716
485 ibid p435
487 ibid p213-214
There is no census in terms of the definition of group CoMI. Though it is desirable for business integrated and control centralized corporate groups to open insolvency proceedings in one court, such types of corporate group may be difficult to be defined and they may not be the majority of the types of corporate groups. It is possible for a corporate group to encompass more than one entity which performs the head office functions. Under such circumstance, the efficacy of group CoMI will be noticeably reduced, as there will still be multiple courts to apply multiple sets of insolvency laws in multiple insolvency proceedings. The next section will consider whether group CoMI could be easily identified under its current definition-place where the head office functions are conducted.

3.5.2 Implications of MCGs theories on procedural consolidation

European large corporate groups typically operate through the network of subsidiaries. When upstream or downstream subsidiaries face financial difficulties, the other subsidiaries in other member states will also suffer. A lack of provisions for groups of companies is one problem identified by the European Commission, even though the number of group cases is large. To achieve the goals of insolvency law, it is desirable if certain rules could allow group going concern values to be preserved on the one hand, and such rules could also provide certainty on the other hand. Based on the insolvency jurisdictional rule-CoMI, it seems to be desirable if the CoMIs of all the

subsidiaries can be found in one place in terms of head office functions. This requires an analysis regarding whether the head office function-related control on subsidiaries is executed in one place.

The business network perspective provides useful insights about the head office and subsidiaries’ relationships which have a bearing on insolvency jurisdiction. The theory reveals that the relationships between head office and subsidiaries should not be simplified to one parent company controlling all the subsidiaries in a hierarchical structure. The danger of such simplicity is that it fails to reflect the reality of how control is exerted in the group.

The deeper the subsidiaries are embedded in the internal network, the stronger the parent company's power to exert control on subsidiaries. Nevertheless, even though parent companies may acquire control through their ownership, they may not exert their control. The pre-condition to exert control is that the parent company needs to make sure that its allocation of resources to one company does not harm the opportunities of other subsidiaries. A parent company therefore needs to balance its control on subsidiaries and subsidiaries' control on other subsidiaries and the parent itself. This does not deny the

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494 For instance, one holding company stay at the apex of the whole group, or in chain style shareholding where the head of the chain owns the majority of shares of its subsidiary, and in turn the subsidiary owns majority of shares of its sub-unit. Bob Tricker, Corporate governance principles, policies, and practices (Oxford university press 2009) p76

existence of and the importance of the hierarchical structure of MCGs; it argues that the real structures of MCGs and control from the parent are better represented from a business network perspective rather than a strict hierarchy.

The phenomenon can be explained as the change of the subsidiaries' roles. The roles of the subsidiaries expand from a local implementer of the parent company to the roles which are in charge of certain technological and business related resources such as R&D and marketing as mentioned above. From resource dependence theory, the parent has to rely on their resources as it cannot understand how to properly use these resources without the facilitation of subsidiaries. As a result, the subsidiaries could use these resources to obtain power and autonomy in certain areas of decision-making irrespective of the desire of parent. In other words, certain subsidiaries' strategies derived from their networks will counterbalance the control from the parent company. This especially true for the subsidiaries which possess technological-related power and may shape the decision-making of the parent company in the area of Research and development (R&D); Similarly, subsidiaries which possess business-related resources may make decision for the group regarding marketing strategies.

The parent may also delegate certain head office functions to other places either through a regional head offices or directly to some eligible subsidiaries. Therefore, there is more than one head office in a given MNC with different head office functions spread across different levels. Research has shown that relatively decentralised subsidiaries are more

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496 Ram Mudambi et al 'How subsidiaries gain power in multinational corporations' Journal of World Business 49 (2014) p109
497 Reason could be for example, causal ambiguity which means difficulty for others to understand the better performance of one player.
498 Mats Forsgren, et al, managing the embedded multinational--a business network view, (Edward Elgar, cheltenham UK 2006) p133
499 Ram Mudambi et al 'How subsidiaries gain power in multinational corporations' Journal of World Business 49 (2014) p103
likely to learn and create value. The relative decentralised decision-making mandate allows subsidiaries to adapt to the local environment and respond to the exigencies quickly. By contrast, a hierarchical and centralised corporate group may not be able to cope with more and more complex environments and win in fierce competition.

All this encourages international companies not to adopt a pure centralised and integrated business form of group, as it prevents the subsidiaries from learning from their environments and from contributing the group. As a result, parent companies need to allow certain subsidiaries to retain decision-making power in the areas where they have valuable expertise. The parent may also delegate certain head office functions to subsidiaries by forming regional head offices. Therefore, there is more than one head office in a given MNC with different head office functions spread across different levels.

For example, the parent company can control the financial arrangements of all the subsidiaries, while certain subsidiaries may control the research and development functions which is at least equally important. As technology-related functions can arguably yield the strongest control, it is difficult to assert that the CoMI of these subsidiaries are in the location of parent company.

As a result, it is difficult to argue that subsidiaries’ CoMIs are in the same location as the parents’. This makes a group CoMI approach doubtful. It is widely accepted that certain types of group may be better treated in a centralised way. The networks that the embedded members have internally and externally are strategic resources. It could be the case that two companies combine their resources in a unique way, thereby gaining

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501 ibid p6
group going concern value.\textsuperscript{504} It is also possible that two companies in a group exchange technologies and adapt to each other by mutual investment.

Networks may also form relational economic rents which cannot be gained by regular market relationships.\textsuperscript{505} Business relationships are the pipes of information, resources, technologies and marketing between member companies, and they can be seen as important intangible resources of companies.\textsuperscript{506} Therefore, it is desirable to have group cross-border insolvency solutions to preserve the group going concern value.

Conclusion

This chapter examines the pivotal concept CoMI in the EIR context. It argues that CoMI is not a very clear concept, while its predictability has been improved by the EIR recast and case law. The chapter further moves to consider the concept of group CoMI. Drawing from the insights from a business network perspective, it concludes that group CoMI is not a predictable concept that could be widely applied to many groups of companies. The next chapter will examine cross-border insolvency theories for corporate groups with reference to this conclusion, especially the theories which are based on group CoMI approach.

3.6 Theoretical proposals and procedural consolidation

There is no group procedural consolidation solution for the cross-border insolvency of MCGs under EIR.\textsuperscript{507} Based on the previous discussion of various cross-border insolvency theories, it is possible to speculate whether some of these theories may be applied to

\textsuperscript{504}ibid p661
\textsuperscript{505}ibid p662
\textsuperscript{506}Mats Forsgren, \textit{Theories of the multinational firm}, (second edition, Edward Elgar publishing limited UK 2013) p108
\textsuperscript{507}From one study, it seems that EIR 2000 does not obtain a desirable satisfaction level from the respondents with regard to group insolvency. ‘Almost half of respondents (49%) felt the EIR does not work efficiently for multinational group insolvencies with 30% feeling it does.’ Commission staff working document impact assessment. Revision of Regulation (EC) No 1346/2000 on insolvency proceedings Strasbourg, 12.12.2012 p52
MCGs. This section will examine the proposed theories for procedural consolidation in an ex ante way and practice for procedural consolidation in an ex post way. The aim is to consider whether procedural consolidation is possible and desirable as a solution for cross-border insolvency of MCGs.

3.6.1 Ex ante approach- group cross-border insolvency theories

This section examines proposals for group procedural consolidation in an ex ante approach. Arguably, modified universalism, contractualism, and universal proceduralism can all be used as ex ante solutions for cross-border insolvency of MCGs.

Though cooperative territorialism could solve group insolvency issues, it does not support procedural consolidation. The reason is that insolvency proceedings may be opened wherever the local courts could find assets belonging to the corporate group, which is especially true in an MNC cross-border insolvency case. Therefore, cooperative territorialism does not offer solutions to pull insolvency proceedings into one court. The following will examine the other three possible candidates.

3.6.1.1 Contractualism

Contractualists propose to replace regulations with contracts. In cross-border insolvency context, the main idea of contractualism is that companies should be allowed to have bankruptcy-selection clauses in the charters. The chosen bankruptcy laws would be the

ones most suitable to administering the bankruptcy of the companies. Members of
companies make the choice at the time of incorporation, and the choice could be changed
later with creditors’ consent. In the case of MCGs, it is possible that many subsidiaries
choose the same jurisdiction as the insolvency jurisdiction so as to achieve procedural
consolidation. However, without insolvency, it may be difficult to find one country whose
insolvency law is the best option for all foreign subsidiaries with considerable different
demand. Contractualism leads to complexity and inflexibility. Companies may need to
change their places of business during the development; or at a certain stage, another
insolvency law may be more suitable to the business. An insolvency law chosen today
may not be a favourable option for the company some years later.

One merit of contractualism is that it is purported to be highly predictable. As the chosen
jurisdiction and insolvency law will be written in the charters of companies, creditors of
companies can calculate interest rates accordingly. Also, as the jurisdiction has been
decided ex ante by contracts, forum shopping may also be reduced. Contractualists are of
the view that companies are in the better position than governments to choose a tailored
insolvency law that is best suited to their business. Also, governments and courts have
little information about the condition of the company, so the company and its creditors are
in the best position to decide where to conduct insolvency and which jurisdiction’s
insolvency laws are best suited to them.

It is, however, possible for influential creditors to choose insolvency law that benefits

universalism’32 Brook. J. Int'l L. 983 2006-2007; Mihailis E. Diamantis ‘Arbitral contractualism in
511 ibid p5
512 Gerard McCormack ‘Jurisdictional competition and forum shopping in insolvency proceedings’ The
Cambridge Law Journal, 68 p178
only for themselves while bypassing the protection offered to the non-adjusting creditors or stakeholders. Non-adjusting creditors such as tort creditors who cannot bargain for their payment will become victims since senior creditors can externalize loss to them under contractualism. Debtors and senior adjusting creditors may choose haven countries to preclude non-adjusting creditors from claiming money. For example, high petition fees discourage creditors with small claims to join in the insolvency proceedings.\(^\text{514}\)

If most of creditors are adjusting creditors in insolvency cases, one may find a plausible reason to support contractualism. However, the number and size of non-adjusting creditors’ claims may not be as small as contractualists suggest.\(^\text{515}\) According to Westbrook’s research, small claims pervasively exist in most of the cases and account for a considerable portion of unsecured claims.\(^\text{516}\) This finding reveals a problem of contractualism in that it may neglect that there are many unsecured creditors and other involuntary creditors who probably have no power to change the content of contracts, thus the contracts will be used as a tool biased towards the interests of debtors and big creditors.\(^\text{517}\) The contracts will choose a jurisdiction which can maximize senior creditors’ value rather than maximizing value for the stakeholders as a whole.

Contractualism lacks measures for assets control and transparency.\(^\text{518}\) Without mechanisms to control the assets of debtors, the agreement is unenforceable in that debtor could transfer assets to other subsidiaries or somewhere else.\(^\text{519}\)


\(^{519}\) ibid p2305
Also, the tailored insolvency law template designed by contractualism may not be broadly replicated by other companies, as unfamiliarity with the chosen insolvency law and risks may make the cost of replication high.\footnote{Robert K Rasmussen. ‘A new approach to transnational insolvency’ 19 Mich. J. Int'l L. 1 (1997-1998) p27} As a result, contractualism may be costly as every company needs to design its own template of insolvency law.

Free choice of insolvency law also ignores the interaction of insolvency law and other laws in one country. Insolvency law closely connects to employment law, corporate governance and secured credit law.\footnote{For the interaction between insolvency law and corporate governance, see John Armour, Brian R. Cheffins, David A. Skeel, Jr. ‘Corporate Ownership Structure and the Evolution of Bankruptcy Law: Lessons from the United Kingdom’ 55 Vand. L. Rev. 1699 (2002) p1701} Allowing parties to choose foreign insolvency law will break such interaction; also, parties may not be familiar with the chosen foreign law.\footnote{Gerard McCormack, Secured credit and the harmonisation of law, the UNCITRAL experience. (Edward Elgar Publishing Limited 2011) p49}

Contractualists try to cure this issue by arguing that forums can refuse to assume or recognize the choice if they think the choice is unjust and unreasonable; the involuntary creditors could not be in a worse position under the chosen law than they would in their own jurisdiction.\footnote{Robert K Rasmussen. ‘A new approach to transnational insolvency’ 19 Mich. J. Int'l L. 1 1997-1998 p35} However, the rejection of recognition itself causes uncertainty.

The \textit{ex ante} determination of jurisdiction and insolvency law under contractualism may provide predictability to stakeholders. But one may argue that a consensus regarding which insolvency law will be chosen may be difficult to achieve; the multiple bankruptcy law options give rise to transaction costs to negotiate an agreement.\footnote{Elizabeth Warren and Jay Westbrook Contracting out of bankruptcy: an empirical intervention 118 Harv. L. Rev. 1197 (2004-2005) p1249} Also, there are significant numbers of creditors in an insolvency case, so the cost of negotiation will
balance out the efficiency of contractualism.\textsuperscript{525} As Professor LoPucki identified, the cost to conclude such contracts would be very high, as every creditor needs to analyze and understand the chosen law and efficiency of the court chosen so as to calculate the risks therein, even where the firm is very healthy.\textsuperscript{526} Free choice of insolvency law is likely to introduce heavy transaction costs as it does not offer an efficient disclosure system to inform creditors to which insolvency law they will subject.\textsuperscript{527}

All these transaction costs will increase in the context of cross-border insolvency of MCGs, as more creditors are expected to join in the process of contracts negotiation. Also, it is difficult to obtain all their approval to change insolvency law.

To make contractualism practicable, all the countries should accept free choice of insolvency law regimes. Currently, it does not have a wide support base. No countries allow participants to decide jurisdiction and choice of law beforehand. As a result, contractualism does not necessarily prove it has the ability to preserve going concern value and to provide high certainty. It may not be the desirable option for cross-border insolvency of MCGs.

3.6.1.2 The modified universalism solution to MCGs

Modified universalism is only applied to an individual company. However, by analogy, one could argue that insolvency proceedings of subsidiaries in a corporate group may be

\textsuperscript{525} ibid p1219
treated like secondary proceedings available under EIR.

Insol Europe suggested one similar solution by designing one concept named ‘group main proceeding’. Group main proceeding is the insolvency proceeding of the ultimate parent. The power of insolvency practitioners in a group main proceeding vis-à-vis main proceedings of subsidiaries is similar to the power of the main proceeding of one company vis-à-vis secondary proceedings of the same company.\textsuperscript{528} Insol Europe believed that this is a modest proposal to apply the current regime to corporate group, especially where the parent and the subsidiaries are all in insolvency.\textsuperscript{529}

Samuel L. Bufford\textsuperscript{530} and Ralph R. Mabey,\textsuperscript{531} also designed a universalist concept named Enterprise-CoMI, arguing that the home country of the group is where the center of main interest of the group is located. Insol Europe's proposed group main proceeding is the insolvency proceeding opened in the ultimate parent company's CoMI place.\textsuperscript{532} Though there are some nuances between the group main proceeding approach or Enterprise CoMI approach, the rationale behind them are nearly the same: all these proposals try to achieve procedural consolidation by designing a group CoMI concept and locating group CoMI in the place of the ultimate parent company. Such suggestions have the benefit of free-riding existing concepts and mechanisms underpinned by modified universalism.

However, it may not be justified to equate the CoMI of the ultimate parent company as the CoMI of the group. Business network perspective provides useful insights in this regard. The reason is that CoMI means the place where the head office functions are

\textsuperscript{528}Revision of the European Insolvency Regulation Proposals by INSOL Europe 2012 p96
\textsuperscript{529}Proposal by INSOL Europe revision of EIR p93
\textsuperscript{530}See Samuel L. Bufford Coordination of Insolvency Cases for International Enterprise Groups A Proposal American Bankruptcy Law Journal
\textsuperscript{531}Ralph R. Mabey Susan Power Johnston, 'Coordination among insolvency courts in the rescue of multinational enterprises’ 34th Lawrence P. King & Charles Seligson Workshop on Bankruptcy and Business Reorganization New York University School of Law September 2008
\textsuperscript{532}Revision of European insolvency regulation proposed by Insol Europe p95
carried out and these functions should be ascertainable to third parties. In reality, for the purpose to gain group going concern value, many head office functions are mandated to the subsidiaries and ascertainable to the third parties. Also, the ultimate parent company may not be an active group member and might not be involved in subsidiaries’ operations at all. Therefore, the concept of group CoMI may not qualify as CoMI of the group. The challenge of applying universalism to deal with the insolvency of MCGs is that it cannot provide a clear enough group CoMI concept.\textsuperscript{533}

Another drawback of the group CoMI approach is that there is no effective way, so far, to eliminate secondary proceedings, never mind the main proceeding of subsidiaries. The purpose of secondary proceedings is, among other things, to protect local creditors’ interests according to the local insolvency law.\textsuperscript{534} The most obvious reason leading to the opening of secondary proceedings is explained by the difference of priority of creditors.\textsuperscript{535} Secondary proceedings may be avoided in some cases, such as employment preservation, where the claims of the creditors could be acceptably reduced to the pecuniary repayment.\textsuperscript{536} Nonetheless, in some cases, one member state provides creditors with not just a monetary priority but also a strong protection involving judicial intervention so that monetary repayment alone cannot make a local court give up jurisdiction.\textsuperscript{537}

Therefore, modified universalism may not provide a desirable solution to consolidate insolvency proceedings in the group CoMI place; among other reasons, one reason is that, according to the insights from business network perspective, such place may not exist at

\textsuperscript{533}Lynn Lopucki, \textit{Courting failure: how competition for big cases is corrupting the bankruptcy courts} (The university of Michigan press 2006) p209
\textsuperscript{535} ibid p580
\textsuperscript{536} ibid p587
\textsuperscript{537} ibid p588
3.6.1.3 The universal proceduralism solution to MCGs

Compared with territorialism and universalism, universal proceduralism (sometimes called virtual territoriality), is a relatively new theory proposed by Professor Janger.\(^{538}\) The main tenet of universal proceduralism is that one court should control one cross-border insolvency case, while it should apply decentralized choice of law rules to decide substantive rights of foreign creditors. The effect of universal proceduralism is that the court which opens the insolvency proceeding should treat the foreign assets and foreign claims as close as possible to the treatment available under local law had the local insolvency proceedings been opened.\(^{539}\) The court only controls the case at issue, while the substantive insolvency rules that have distributonal effects, such as priority, avoidance law, and reorganization plan, should be replaced by foreign local insolvency law.\(^{540}\) As the power of court in which the insolvency proceedings are centralized is reduced, the incentive of forum shopping is lower than that in universalism. Any change of the forum will not necessarily change the applicable law to certain claims and assets.

Professor Janger believes that universal proceduralism has the advantages over modified universalism. He argues that in the corporate groups context, it is desirable to allow the court of group CoMI to administer the whole proceedings on behalf of group members,

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\(^{540}\)ibid p435
while requiring the court to apply the local law of subsidiaries’ jurisdictions determined by their respective CoMIs.  

Applying local substantive insolvency law could be seen as reciprocal comity in the sense that not only local courts defer to the court of main proceeding, but also the main proceeding respects the local interests. Universal proceduralism provides balance between the desirable result of centralized insolvency proceedings and protection of local creditors. Local creditors’ reliance on local law vindicates the need to protect local interests by applying local law. For example, if local employment law provides local workers certain benefits which are not available under foreign insolvency law, local workers expect local law should be applied to protect them. Designing rules solely based on local creditors' various or even conflicting expectations may be too subjective. A better way is to replace subjective creditors' reliance with harmonized choice of law rules. This approach may require the law to determine what are local interests, who are local creditors, and what are local assets. For example, it may be the case that local interests are protected by the court of main proceeding only to the extent of local establishment-related local assets. Such rules provide objective rules to direct local creditors' expectations. In the case where the local court does not possess CoMI or establishment and creditors who do not have right in rem locally, they cannot subjectively argue that they base their expectations on local insolvency law rather than the insolvency law of the main

541 ibid p434
543 EU regulation on insolvency proceedings recast 2015 Article 2 Definitions: ‘local creditor’ means a creditor whose claims against a debtor arose from or in connection with the operation of an establishment situated in a Member State other than the Member State in which the centre of the debtor's main interests is located.
546 ibid p146
proceeding. 547

There are many drawbacks with procedural universalism. One is that virtual territoriality, similar to universalism, relies on the group CoMI concept to centralize insolvency proceedings in corporate group cases. 548 It is impossible to take such a one size fits all approach in the cross-border insolvency context of MCGs, as it does not provide clues regarding the group CoMI location and whether it is always desirable to allocate the CoMIs of subsidiaries to one place.

Universal proceduralism may also be criticized because it connects local assets to local interests. 549 The assets situated in one jurisdiction do not by themselves mean that such assets are local assets. Conferring jurisdiction by assets is not reasonable; it gives too much power to the local law and benefits local creditors without justification. 550 The location of assets by itself is not the relevant test make the court of main proceeding to apply local insolvency law; it is the actual local interests that deserve local law protection. 551 Also, not all creditors should be protected by local insolvency law if they are not offered priority.

Another thing worth mentioning is that the scope of local assets under procedural universalism may be too broad if they are roughly defined as all the assets that are located locally. Some assets may not be connected to the local establishment and local operation, so local interests should not benefit from this windfall simply because they are luckily the

547 ibid p141
local creditors of the country.\textsuperscript{552} The Nortel case\textsuperscript{553} provided an example in this regard. The proceeds from the sale of the IP assets of the corporate group were pro rata allocated to member companies, rather than only to the creditors of the company that holds the property.

Under modified universalism, there are certain rules such as the establishment test to restrict opportunist debtors or creditors from opening secondary proceedings and using local laws in their own interests.\textsuperscript{554} By contrast, under universal proceduralism, debtors and creditors without similar constraints may abuse local insolvency law and gain benefit at a cost to other creditors. The court may be also overburdened by dealing with multiple sets of local insolvency laws, and the court may have difficulties in understanding local law.

Another practical difficulty is the difficulty of classifying procedural and substantive insolvency laws. In order to make virtual territoriality practical, one has to clearly divide national insolvency laws into procedural rules which do not have distributional effects and other procedural and substantive insolvency rules that do. What makes it even more complex is that certain procedural rules such as the stay provisions in insolvency laws could cause substantive consequences as it affects secured creditors’ rights.\textsuperscript{555}

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\footnotesize{\textsuperscript{552}One may further suggest that even though the secondary proceedings are initiated by local courts, the non-establishment assets (the assets that are not relevant to local operation) should be subject to the insolvency law of the main insolvency proceeding. This way makes the regime more like universalism. Charles W. Mooney, Jr. ‘Harmonisation choice of law rules for international insolvency cases: virtual territoriality and virtual universalism and the problem of local interests’ Brooklyn Journal of Corporate, Financial and Commercial Law 2014 p141,p146

\textsuperscript{553} In re Nortel Networks, Inc, 532 BR 494 Bankr D Del 2015

\textsuperscript{554} Ian F. Fletcher insolvency in private international law Second Edition oxford university press p376

\textsuperscript{555} Jay Lawrence Westbrook ‘comments on universal proceduralism’ 48 Colum. j. transnat’L. 503 2009-2010 p515}
Janger is of the view that Collins and Aikman case is the manifestation of virtual territoriality. The Collins and Aikman group (CA group) is a corporate group that manufactures car parts. The European subsidiaries entered into administration insolvency proceedings in the English high court. Even though the subsidiaries were incorporated in different member states, the joint administrators were appointed by the English court for the purpose of a better recovery. To prevent the local creditors from opening secondary proceedings, the joint administrators promised that their priority would be treated as if the secondary proceedings had been opened in respective member states. The result would be a higher sale price and a higher return to all the creditors.

The English court and administrators clearly understand that to achieve a better result, procedural consolidation alone is not enough; they also need to avoid secondary proceedings as the different local law will interrupt the rescue in the main proceeding. This pragmatic path of the CA group case is named as 'synthetic secondary proceedings'. The rationale of synthetic insolvency proceedings is to serve the goal of maximization of the insolvency estate by procedural consolidation. In some cases, the opening of secondary proceedings will dismember the whole business of a distressed group, thus impeding the possibility of a group reorganization. Also, the cost may be high by opening numerous insolvency proceedings. The entity law approach prevents the reorganisation procedure to achieve value maximisation goals.

The precondition of the viability of synthetic secondary proceedings is that all the CoMIs of subsidiaries can be said in the location of one member state; the court of opening of main insolvency proceeding should have authority to guarantee monetary compensation.

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556 In the Matters of Collins & Aikman Europe SA and Others [2006] EWHC 1343 (Ch)
558 In the Matters of Collins & Aikman Europe SA and Others [2006] EWHC 1343 (Ch) p1
to the aggrieved creditors in other member states; the other member states may also agree to compromise such synthetic treatment of creditors without applying their own insolvency law.

However, neither of these conditions can be met in reality. From a business network perspective, certain subsidiaries can take on innovative roles and implement head office functions. It is difficult to justify procedural consolidation. One should note that it is difficult for other courts of civil law countries to approve such undertaking in the same fashion, as civil law courts generally may not enjoy flexible discretion as case law jurisdictions do. Without the flexibility of the English court and the acceptance of local creditors, the CA case is difficult to replicate.

More importantly, it is not clear whether such practice is cost efficient, due to the uncertainty in the content of promises, valuation of assets and reaction of creditors. Without the evidence to show that local creditors benefit from such practice but do not fall victim of it, it is also hard to say synthetic secondary proceeding is a reliable solution.

Universal proceduralism and modified universalism may have only little difference in practice. While modified universalism applies the rule of main proceeding to decide control, priority, avoidance rules and reorganisation plan, universal proceduralism insists that the local insolvency law should be applied to decide local creditors’ priority. In cross-border insolvency of MCGs cases, both universal proceduralism and modified universalism rely on a group CoMI concept to achieve procedural consolidation.

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562 It appears that the EIR recast has codified synthetic secondary proceedings in Recital 42, while how it will be practiced remains to be seen.
564 ibid p618
With careful deliberation, the CA case is not based on virtual territoriality, but still on modified universalism. The prerequisite of opening main proceedings for the European subsidiaries is that their CoMIs are in the jurisdiction of the English court. Without this pre-condition, the CA case would have caused considerable uncertainty in that all the subsidiaries’ insolvency proceedings could have been attracted to the parent company’s jurisdiction even if the CoMIs of them are not in that country. Therefore, it appears that virtual territoriality does not provide a new jurisdiction-selection rule for corporate group cases. It ends up with unclear rules to pull insolvency proceedings, which is unpredictable.

The unclear group CoMI rule will invite forum shopping, especially in the EIR which confers the obligation of automatic recognition of main proceeding’s jurisdiction. This automatic recognition entails the acceptance of all the member states of application of a different country’s insolvency law. Considering the unclear group CoMI and the notable discretion of courts, the possibilities of forum shopping cannot be ignored.567 Forum shopping may be more fierce and harmful at an international level, as the changed applicable laws provide creditors with strong incentives.568

Conclusion

By exploring all three proposals for cross-border insolvency of MCGs, one may draw the conclusion that current cross-border theories may not provide a predictable and desirable solution to deal with MCGs in an ex ante way. This is at least partly because no proposal can provide a clear jurisdiction rule. The next part will examine ex post procedural consolidation solutions and check their desirability.

568 Lynn Lopucki Courting failure: how competition for big cases is corrupting the bankruptcy courts (The university of Michigan press 2006) p207
3.6.2 Ex post approach of procedural consolidation

Procedural consolidation may be arranged ex post by means of insolvency jurisdictional rules. Senior creditors may persuade a court to seize jurisdiction of many group member companies even if the CoMIs of group member companies may not be in the territory of that court. Alternatively, creditors or debtors may move CoMI to other countries to make it eligible to use foreign insolvency laws such as pre-pack administration.

The ex post approach, may overcome the obstacles of varying member states’ insolvency laws, and avoid the cost of opening many parallel insolvency proceedings. However, foreign insolvency law may not be used to serve the interests of creditors in general. Rather, it may be the tool exploited by the senior creditors to redistribute the value from junior creditors to senior ones. Another aspect is that alteration of jurisdiction means alteration of creditors’ rights under cross-border insolvency law. The cost of uncertainty may be significant.

3.6.2.1 Ex post approach by CoMI interpretation

The English courts provide examples of how to deal with the insolvency of MCGs under EIR. One of the cases is the Daisytek case. The English court, after analyzing the factors determining CoMI, held that all the CoMIs of the subsidiaries in Europe are in the UK. Based on this evidence, the English court opened the main insolvency proceedings regarding all these subsidiaries. The effect of procedural consolidation was achieved. It

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569 Re Daisytek-ISA Ltd [2004] B.P.I.R. 30
may be argued that this case confirmed the ‘head office test’ developed by the English court and that it is useful to resolve corporate group insolvency cases.\textsuperscript{570} The English court was also convinced that elements used to determine head office functions are also on the basis of objective factors which are ascertainable to the third parties.\textsuperscript{571}

However, one should not be too optimistic to believe this is the perfect and easy solution to corporate groups. As above mentioned, in many other cases, the CoMIs of subsidiaries may not be coincidently in one jurisdiction. If the court still wants to achieve procedural consolidation by interpretation, it will damage creditors’ expectations. Only in the corporate groups which are neatly centrally controlled and integrated with regard to the business, is it possible to achieve a result similar to that of the Daisytek case whereby one forum and one set of insolvency law is applied.\textsuperscript{572} However, as previously discussed, in reality, head office functions are not neatly located in one company in a given group, which may render this approach implausible to apply in many cases.

To allow courts to seize insolvency jurisdiction by interpretation of CoMI is not without controversy. It is argued, especially in the US context, that the insolvency courts are not reliable enough to determine CoMI, as they may compete for the insolvency jurisdiction; the courts are more likely to act in favour of managers and other allies rather than the unsecured creditors.\textsuperscript{573} As big cases are usually lucrative, the courts and insolvency practitioners cannot be expected to give them up to other jurisdictions.\textsuperscript{574}

\textsuperscript{571}ibid p181
\textsuperscript{572}Irit Mevorach, ‘Cross border insolvency law of enterprise groups: the choice of law challenge’9 Brook. J. Corp. Fin. & Com. L. 107 (2014) p6
\textsuperscript{573}Lynn M. LoPucki, Courting failure: How Competition for Big Cases is Corrupting the Bankruptcy Courts (The University of Michigan Press 2006) p243
\textsuperscript{574}ibid p221
Though the effect of CoMI interpretation can be tempered by secondary proceedings under EIR,\textsuperscript{575} the uncertainty that such practice can cause should not be underestimated. From a business network perspective, foreign subsidiaries may have been allocated head office functions for the purpose of generating group going concern value. Local creditors may well percep that the local subsidiaries are not fully controlled by the parent companies so that it is the local insolvency law that should be applied to these creditors. CoMI interpretation changes the applicable law to those creditors. No matter whether a centralized group rescue plan can bring a good result to the creditors, the uncertainty may likely give rise to an increase of interest rate. As predictability is an important goal that cross-border insolvency law aims to pursue,\textsuperscript{576} CoMI interpretation runs the risk of creating uncertainty.

3.6.2.2 Ex post approach by forum shopping

Using forum shopping as a method to achieve procedural consolidation is dangerous for several reasons. The foremost one is that forum shopping may destroy group going concern value. From a business network perspective, the relationships among member companies are the main component of the group going concern value of MCGs. Part of the group going concern value is gained through the foreign subsidiaries in that they can absorb foreign countries' specific advantages. Forum shopping, under EIR recast, generally requires debtors to move CoMI to another country for the purpose of procedural consolidation. This move may change the environment where foreign subsidiaries are embedded and cut off the conduits on which foreign subsidiaries rely to gain foreign resources and capacities.

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\textsuperscript{575}David A Skeel, ‘European implications of bankruptcy venue shopping in the US’ 54 Buff. L. Rev. 439 (2006-2007) p459

As a result, a real transfer of CoMI means that foreign subsidiaries cannot transform the advantages of foreign countries into the group going concern value, as their business locations have been changed. These transferred subsidiaries cannot transform the country-specific resources into company-specific resources and transfer these value to the MNCs. The decrease of the value as a result of a forum shopping may outweigh the cost saved by procedural consolidation.

Also, procedural consolidation by forum shopping will give rise to uncertainty, as junior creditors are less likely to have no decision-making power to decide where the CoMI should be transferred. Furthermore, certain foreign insolvency law procedures such as pre-pack administrations may benefit senior creditors at the expense of junior ones. The main reason that debtors and certain senior secured creditors prefer pre-pack sales is to pursue their own interests.

The Wind Hellas case is a notorious example of forum shopping for the purpose of making use of UK pre-pack administration and schemes of arrangement. This is also the case involve procedural consolidation as six companies in the group transferred CoMIs to the UK. The result attracted heavy criticism as it left the unsecured creditors with 1.5 billion Euros unpaid.

The Hellas group has business in the telecom industry in Greece, of which Wind Hellas is the main operational company in the group. Hellas II is the parent of Wind Hellas. Hellas II was likely to default on its debt, so it decided to move its CoMI to the UK to utilize the UK pre-pack administration to sell its shares in Wind Hellas to the buyer.

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577 Pre-pack blurs the line between formal and informal rescue procedures, and further it gains popularity gradually as it almost accounts for no less than a third of all going concern sales S. Davies QC, ‘Pre-pack—he who pays the piper calls the tune’ recovery summer 16 2006 p17 (Cited by Vanessa finch Corporate insolvency law perspectives and principles second edition Cambridge university press 2009 P456)


579 Financing briefing, Slaughter and May, December 2009
Hellas II transferred its CoMI three months before the opening of insolvency proceedings.\textsuperscript{580} As Hellas II is a financing company, though the judge recognized that the property it possesses is not much in the UK, it was convinced that its CoMI has been shifted.\textsuperscript{581}

However, such enforcement sale has to be conducted according to the certain terms of the inter-creditor agreement, and among other things, it does not allow security agents to release principal and interests of inter-company debts between Wind Hellas and other holding companies.\textsuperscript{582}

Hellas III, Hellas IV, Hellas V, Hellas VI are all holding companies in the group which bear debt and obligation of guarantees stipulated in the same inter-creditor agreement. As a result, the holding companies and the parent of Wind Hellas all decided to move CoMI to the UK to use schemes of arrangement and pre-pack administration to facilitate such a sale. As a result, Wind Hellas shares could be sold free of any subsidiaries, principal and interests obligations.\textsuperscript{583}

The UK court found that there were two bids to purchase the Wind Hellas shares available, one provided by senior creditors, the other provided by the subordinated notes creditors.\textsuperscript{584} As the inter-creditor agreement required the proposal supported by subordinated notes creditors to be approved by senior creditors, when the senior creditors did not approve it, the only bid remaining was the senior creditors’ one.\textsuperscript{585} Therefore, the subordinated creditors were contractually not entitled to receive compensation.

\textsuperscript{580}Re Hellas Telecommunications[2009] EWHC 3199 (Ch) p4
\textsuperscript{581}ibid p4
\textsuperscript{583}ibid
\textsuperscript{584}Katrina Buckley ‘Wind Hellas: pre-packs and COMI shift; abuse or innovation?’ (2010) 6 JIBFL 342 p4
\textsuperscript{585}ibid p4
One may find a good reason to support forum shopping in this case, as if the restructuring were not to happen, the whole group value would dissipate quickly; in a hypothetical liquidation proceeding of Luxembourg, the subordinated notes creditors may still not receive anything, while senior creditors are left worse off. However, one may also note that subordinated notes creditors complained about the bid method of Wind Hellas in pre-pack. The whole process was suspiciously rigged by the debtor, since some information was only available to the successful bidder but not to others. It was because there was only one bidder in this case so the court had no alternative option but to approve the only pre-pack sale bid.

In the Wind Hellas case, the terms in the inter-creditor agreement prevent senior creditors from releasing junior creditors' rights; the terms can be seen as a protection to junior creditors. However, the group, controlled by the senior creditors, successfully went around the protection by forum shopping of six financing companies. The purpose was to overcome the obstacles by using a more favourable and flexible restructuring law. However, this change dramatically modified junior creditors' expectations and the drawbacks of the flexible restructuring law, such as pre-pack, could be released if it was not used properly. Therefore, one should be doubtful about the ex post procedural consolidation by forum shopping. Also, as above-mentioned, if it happens in the case of operating companies, the result may be far more harmful.

3.7 Conclusion

As the above analysis indicates, cross-border insolvency law theories face difficulties in being transformed to their group version. Though cost may be reduced by centralizing the

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586 Re Hellas Telecommunications [2009] EWHC 3199 (Ch) p5
587 ibid p5
insolvency proceedings of subsidiaries to their ultimate parent’s one, the cost from the uncertainty may outweigh the benefits from centralization.

The main difficulty arises from the group CoMI concept. As in many corporate group cases, the CoMIs of the subsidiaries are not in the place of parent company, so the practice of procedural centralization may cause uncertainty.

Procedural consolidation may contain inherent drawbacks in solving cross-border insolvency issues for MCGs. The next two chapters will examine how the market develops solutions for MCGs, and whether the group coordination proceedings can be used as better solutions.
Chapter 4 Market/Hybrid approaches to cross-border insolvency of MCGs in the EU

Chapters 2 and 3 provide theoretical and factual grounds to analyze existing solutions to cross-border insolvency of groups of companies, and show that procedural consolidation has serious limitations and drawbacks. The uncertainty of group CoMI location poses a difficult question for cross-border insolvency law theorists. At least from a theoretical aspect, insolvency jurisdictional rules may not be used to achieve procedural consolidation. As insolvency law is closely connected with the advance of credits, uncertainty created by procedural consolidation may negatively affect credit arrangements with regard to solvent companies.

Parallel to theoretical solutions for cross-border insolvency of MCGs, market solutions alone or in combination with insolvency proceedings are also used in practice as solutions for cross-border insolvency of MCGs.

The task of this chapter is to examine advantages and limitations of the second practical solution: market solutions/hybrid solutions dealing with the cross-border rescue of MCGs. It begins with an overview of categories of rescue. It includes private restructuring solutions, hybrid restructuring solutions and insolvency protocols. Then the chapter moves to examine the limitations of private solutions from both practical and theoretical points of view. Following it, two group market/hybrid solutions will be examined. They

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588 By allocating insolvency jurisdiction of subsidiaries to the court possessing group CoMI, the insolvency of the whole group can be handled in only one court.
589 Vanessa Finch, Corporate insolvency law perspectives and principles (Second edition Cambridge university press 2009) p69
could prevent the entire corporate groups from entering into insolvency by renegotiation of debt agreements at holding companies level.

Sometimes, the complicated categories of debts and creditors render private solutions unable to deal with the debts renegotiation; debtors and creditors in these situations are forced to seek recourse of hybrid solutions such as a pre-pack sale of shares in operating subsidiaries to the company owned by senior creditors. Also, it is possible for creditors to reach cooperation protocols to deal with cross-border insolvency issues. This chapter analyses whether these solutions provide desirable results for cross-border insolvency of MCGs and whether they have limitations.

**4.1 Types of rescue**

There is no universally acknowledged definition and method of rescue. Formal rescue regimes such as administration, hybrid regimes such as a 'pre-pack' sale of business and informal rescue such as private negotiations between debtors and creditors can all be seen as rescue methods.\(^{590}\) The measures of rescue could be in either informal (i.e. workout by private negotiation), formal (court supervised insolvency proceedings) fashion or a hybrid way such as pre-pack.

In many rescue cases involved with informal rescue methods, the categories of creditors are various and the number of them is notably large, and the hold-out issues may not be easily solved by private contracts, which require unanimity.\(^{591}\) Creditors may only be able to reach a private agreement regarding how to distribute the assets of the insolvent debtors when the number of creditors is small.\(^{592}\) In other words, where the numbers of

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\(^{590}\) Vanessa Finch, 'Corporate rescue: a game of three halves' (2012) Legal Studies, Vol. 32(2)


creditors are very large and categories are complex, the chances of drafting a private plan among all creditors may fade away.

Formal rescue procedures are court supervised, so the benefits of it are that many useful insolvency mechanisms can be used, such as stay and refinancing. Also, a broader range of interests could be protected according to the bankruptcy policies. Therefore, informal and formal rescue measures could be considered as a supplement to each other. The aim of both formal and informal rescue measures is to keep the business running as a going concern.  

Hybrid rescue procedures are also called pre-insolvency procedures, which purport to mix the benefits of both formal and informal insolvency measures. Taking pre-pack as an example, it is said that pre-pack could reduce the cost of rescue and save time. Its main feature is that a reorganisation plan is drafted and confidently approved with the consent of only secured creditors, by out-of-court appointed administrators, before the opening of administration proceedings.  

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593 Alice. Belcher, *Corporate rescue* (Sweet &Maxwell London 1997) p72
4.2 The limitation of alternative approaches to insolvency law and out-of-court solutions

4.2.1 Theoretical limitations of contract approaches

Some scholars claim that contracts may be used to replace corporate rescue regimes.\(^{596}\) The common ground of such approaches is that creditors and companies can negotiate contracts *ex ante* regarding how to deal with the insolvency of debtors.

The main thread of these alternative methods argues that contracts and markets could provide a lower-cost solution than traditional rescue regimes. For example, auction may be used to implement a sale of the business to third parties at a fair price; auction could also help to preserve the going concern value by selling the business as a whole.\(^{597}\) The benefit yielded from substituting auction for rescue is that auction can avoid delay and redistribution in traditional rescue proceedings. The price sold can indicate which parties are still in the money and which parties are out of money. The court only needs to distribute the proceeds from of the auction along with the priority of relevant stakeholders.

Other approaches focus on contracts whereby the shares of insolvent companies are reallocated in the hands of creditors; the creditors in the lower ranking have the right to buy shares from the senior creditors if they believe the going concern value is large. These similar approaches assume that the court should sell the distressed business and then distribute the proceeds to the senior creditors; the lower creditors are allocated options to buy the shares from the senior creditors.\(^{598}\) Also, parties could negotiate contracts regarding how to distribute assets when the debtors are bankrupt. For example,

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Professor Adler provided an idea of chameleon equity to resolve insolvency issues. When a company is insolvent, the equity of shareholders will be cancelled; the highest residual claimants will become the new shareholders. If the lower residual claimants believe that the going concern value is higher, they may bid for the shares from the senior creditors. This activity provides senior creditors with a means of exit.599

Contract and market approaches bear three main drawbacks which almost make them impossible to be adopted. The first is the significant transaction costs arising from these approaches. The efficient solutions of contract and market approaches assume a perfect market with zero transaction cost. However, in the complex world of insolvency or international insolvency, this assumption is far from the reality. Insolvency law is incredibly complex, more so when many insolvency jurisdictions are involved. The capital structures of most international companies are very complex; the categories of creditors are various; the conflicts of interests between different parties are serious; and the access to information is asymmetrical among different parties. The complicated relationships between debtors and myriad of creditors and different national insolvency laws make such contracts difficult and costly to draft, if not impossible to do ex ante.

One could imagine the difficulties for parties who would like to buy the shares from senior creditors to raise capital. The reorganization procedure may keep the distressed companies in the hands of existing creditors and shareholders without the need to raise money if a compromise among them could be reached. In the contract and market approach, either auction or buying shares from senior creditors will generate costs of raising capital which may outweigh the cost of a traditional reorganisation procedure.600 What one also needs to bear in mind is that sometimes the bankruptcy market is too thin to support auctions, so a more likely result will be an undervalued sale.

of the business; a distressed company may have to rely on the existing managers, shareholders or creditors for liquidity. Such illiquidity issues can better be eased by reorganization procedures, giving some breathing space to the debtors. Other cost such as negotiation and communication fees are very likely to be huge, considering the number of creditors and categories of debts.

The second problem is that contracts cannot easily resolve the conflicts of interests of complex insolvency cases. As different classes of creditors do not share the same interests, the decision-making of any class of creditors may not be in the interest of the general creditors. It is almost intractable for the contract to identify the residual claimants in advance. Without knowing the entitlements of each creditor, no possible way could be found to allow the court to either distribute proceeds or allow creditors to bid for the shares of insolvent companies. As a result, a contract that requires shareholders automatically to pass control and interests to the higher-ranking parties is difficult to draft. Drafting such contracts for every company, many of which will not be insolvent in the future will introduce significant cost. Even if parties could draft such unusual contracts, the changing nature of the world and business, will force terms of contracts and solutions to be regularly reconsidered. That is why, there is a role for rescue procedures to play in the insolvency context.
The third drawback of the contract and market approach is that no neutral platform as
courts exist in reorganisation procedures to provide information and resolve disputes for
all the relevant parties.\textsuperscript{608} The rescue procedure imposes obligations on relevant parties to
disclose information and punish the ones who provide false information. Also the
traditional rescue procedure could provide clean title after the sale of debtors' assets,
which are not possible without resort to such rescue procedures.\textsuperscript{609} The traditional rescue
regime also encourage parties to cooperate, such as paying certain important trade
creditors first in exchange for their support. Without such mechanisms, if the auction
takes a period of time and suppliers stop cooperation, the sale will be frustrated as the
value of the business drops significantly.\textsuperscript{610}

The proposal to use contracts and markets to replace traditional rescue procedures may
not be workable. The traditional rescue procedures, though far from perfect, still have
very important roles to play.

4.2.2 Practical limitations of out-of-court approaches

In theory, insolvency law cannot be replaced completely by contracts. This section goes
on to examine whether without the support of insolvency tools, out-of-courts solutions are
increasingly difficult to resolve insolvency issues.

4.2.2.1 Hold out

\textsuperscript{608}Douglas G. Baird, 'The Hidden Virtues of Chapter 11: An Overview of the Law and Economics of
Financially Distressed Firms' (1997) Coase-Sandor Institute for Law & Economics Working Paper No. 43,
p34

\textsuperscript{609}ibid p34

\textsuperscript{610}Stephen J. Lubben, 'Some Realism about Reorganization: Explaining the Failure of Chapter 11 Theory'
When considering the weakness of market solutions for insolvency of companies, the starting point is from the collective nature of the insolvency law. Insolvency law deals with a group of creditors and stakeholders rather than a handful of people. As a result, each creditor may either take individual action against debtors or veto the rescue agreement which is negotiated on the basis of the contracts. Without all the creditors' approval, the drafted plan cannot be executed as contracts cannot be negotiated without other parties' consent. This creates a hold-out issue.

The hold out problem is probably the most conspicuous weakness of informal rescue as unanimity is a requirement of private rescue by contracts. Compared to the formal insolvency proceedings, the most notorious disadvantage of informal rescue is that it is contract-based. Therefore, in most of cases, unanimous agreements has to be achieved.\textsuperscript{611} Where the dissenting creditors are not happy with the terms of contract, including waiver of debt or postponing payment, they may choose not to accept the informal rescue plan and file for insolvency proceedings in the courts.\textsuperscript{612}

Since 2000, companies have started to borrow from a wide range of lenders including banks bondholders, hedge funds and private equities. It leads to a complex and fragmented corporate debt structure such that negotiation of informal restructuring of debts is a challenging task while formal insolvency proceedings may have more chances to be initiated.\textsuperscript{613} To put it in a cross-border insolvency context, the possibility for the banks to achieve consensus among all affected creditors is likely to be more untenable.\textsuperscript{614} In a modern restructuring case, banks may be substituted by various

\textsuperscript{611}Vanessa finch Corporate insolvency law perspectives and principles (Second edition Cambridge university press 2009) p253
\textsuperscript{612}ibid p253
\textsuperscript{613}John Armour, 'The rise of the ‘pre-pack’: corporate restructuring in the UK and proposals for reform' Restructuring Companies in Troubled Times: Director and Creditor Perspectives', (2012) Ross Parsons Centre Sydney Law School p1
\textsuperscript{614}Finch Vanessa, ‘corporate rescue in a world of debt’ (2008) Journal of business law p9
distressed debt investors who do not have existing lending relationship with debtors.\textsuperscript{615}

Furthermore, the prevalent of the use of credit derivatives, such as credit default swaps, may cause trouble for the distressed company wishing to be rescued.\textsuperscript{616} The credit-holders may benefit more by default of debt than payment from an uncertain corporate rescue, so they have incentives not to rescue the company. Therefore the informal cooperation may be stymied by conflicting incentives of complex categories of rights-holders.\textsuperscript{617}

The distressed debt market may increase the difficulty for the creditors to reach a restructuring plan at a low price due to the continuous change of creditors.\textsuperscript{618} When hedge funds and private equity join in the debt finance group, coordination between those who hold different strategies and objectives is more difficult to achieve.\textsuperscript{619} Hedge fund managers often favour short-term investment. Unlike banks which get involved in private restructuring at an earlier date to try to rescue companies, hedge funds may have short-term conflicts of interests over other parties.\textsuperscript{620} For example, hedge funds may either have strong incentives to conduct a pre-pack fire sale to reap the value or holdout for a favourable deal where they are junior creditors but can control a voting class.\textsuperscript{621}

Also, when the creditors bought credit default swaps (CDS), their exposure to the distressed company is insured at the time of negotiation of the private restructuring plan,
as the CDS will be triggered should credit events such as 'bankruptcy', 'restructuring' or 'failure to pay' happen before the maturity date. These creditors may decide not to leave the bargain desks, and they do not want to support promising rescue plans as they may get more if the company defaults even at the expense of other creditors. All these examples show that creditors are of different categories and their motives are various so that private restructuring may not work in all cases. During negotiation stage of an informal rescue plan, the buyers may have a strong incentive to file for bankruptcy petitions so as to trigger the credit event. In the case of restructuring, even though the prospect of the restructuring may benefit the CDS rights-holder, it may not be as favourable as what the rights-holders would get from a default, so the CDS rights-holder may still choose not to cooperate.

Arguably, distressed investors may be incentivized to capture the long-term interest from the insolvent companies and control them, as opposed to short-term creditors who do not purchase enough shares or debts of insolvent companies to be able to do so. Senior creditors have bargained for themselves useful terms in the debt covenants from which the control of the distressed companies are switched to them both before and after the insolvency proceedings. Investors may still hold the stakes of the debtors for a long time to reap maximum interests after they emerge from the bankruptcy. Where the distressed investors inject new capital as debtor-in-possession financing (DIP

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622Restructuring here only means the ones give creditors less favourable terms of rights or priority, but not point to the one could improve the status of creditors. see ISDA Credit Event definitions http://credit-deriv.com/isdadefinitions.htm
financing), their interests are deeply tied with distressed companies; investors as such have incentive to maximize the whole value of the companies. Nevertheless, uncooperative strategies cannot be ruled out.

Also, some believe that such cases will help restructuring as the creditors who do not want to stay in the restructuring plan can find ways to leave without risk of further enforcements. This argument may be undermined by the fact that whether creditors decide to leave or not depends on their positions in the negotiation. If they can exert some control of the plan, they may decide not to leave at a discounted price in the distressed debt market.

To sum up, private restructuring faces significant challenges, as the creditors and categories of debts are so fragmented. It could be argued that private restructuring may not always be an option or it may not necessarily be cheaper than insolvency procedures as the transaction cost may rise sharply due to the difficulties in negotiations. The more creditors are involved, the more possible it is that the private restructuring is not available.

The implication of these changes poses significant challenges to MCGs. As MCGs may have fragmented categories of debts and creditors, private market solutions may not be always available. The limitations of market solutions will be further examined in section 4.3.

629 DIP financing is financing arranged by a company while under the Chapter 11 bankruptcy process. DIP financing is unique from other financing methods in that it usually has priority over existing debt, equity and other claims. http://www.investopedia.com/terms/d/debtorinpossessionfinancing.asp
4.2.2.2 Narrow protection

Arguably, another weak point of the informal restructuring is that certain junior creditors on the lower rungs of the creditors' ladder may be unfairly treated by the proposed plan of senior creditors due to a lack of bargaining power and monitoring power. Unlike insolvency law which provides a forum to monitor the behavior of relevant parties, unbalanced bargaining power and asymmetric availability of information make junior creditors unable to protect themselves by contracts.

As a result, informal rescue may not fairly consider the interests of some junior creditors, as junior creditors are too short of investigation and bargaining power to discuss a possible rescue plan. Where the transparency of procedure and adequate information cannot be provided, junior creditors' interests may be seriously damaged. It provides only a narrow consideration to the companies and senior bank creditors while it may undervalue the protection of other stakeholders who deserve protecting. By contrast, formal insolvency proceedings provide a platform to all stakeholders to decide the future of the companies.

To sum up, even though out-of-court approach provides certain value such as lower costs, insolvency rescue law cannot be replaced by contacts and out-of court private solutions. Out-of-court corporate rescue solutions based on contracts have limitations when it comes to resolve insolvency issues, such as hold-out. Hence, corporate rescue needs insolvency law tools for support if desirable results are to be achieved.

635 ibid p253
4.3. A typical market solution- London approach

It is true that informal restructuring solutions can be exploited for cross-border group insolvency. If creditors of one viable but financially distressed group can contractually reach a new agreement so that the group can recover from unsustainable indebtedness, a group-wide insolvency is avoided. In some cases where the evidence could be obtained that private restructuring could be cheaper than formal full-scale insolvency proceedings, rational parties may choose private restructuring. Many corporate rescues are carried out in informal fashions. It holds that informal rescue may reduce the insolvency stigma as it does not require publicity. Also, the cost of informal rescue may be cheaper as courts are not involved (or involved at a minimal level). Besides these benefits, managers and directors need not to worry about displacement by insolvency practitioners in a formal rescue. Furthermore, filing insolvency petitions will impose disclosure obligations on debtors to make sensitive information available to the public.

The London approach is the typical example of an out of court solution for insolvent

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637 When one company suffers economic insolvency as chapter 2 discussed, (for example, the distress arise from that fact that it loses the core competitive advantage,) the only possible way is to sell its assets in liquidation proceedings, but not restructuring. Roy Goode, principle of corporate insolvency law 4th Edition Sweet Maxwell London 2011 p476
640 Insolvent companies will suffer indirect bankruptcy cost such as higher interest rates and decreased power to bargain for favorable terms of contracts. The indirect cost also includes the negative impact to the parties in the same network, which is difficult to estimate. Wilbur N. Moulton and Howard Thomas ‘Bankruptcy as a Deliberate Strategy: Theoretical Considerations and Empirical Evidence’ (1993) Strategic Management Journal, Vol. 14, No. 2, pp. 127
642 Michelle M Harner and Jamie Marincic, ‘Behind Closed Doors: The Influence of Creditors in Business 34 Seattle U. L. Rev. 1155 (2010-2011) p1156Advantages of a workout lower administrative costs; lower professional fees; increased control and flexibility; less management distraction; generally, no loss of management control; better preservation of going concern value than Reorganizations’ Disadvantages of a workout no ability to bind dissenting creditors or classes of creditors; no automatic stay protection; no ability to recover preferences; no ability to recover fraudulent conveyances Rodrigo Olivares-Caminal et al. Debt restructuring (OUP 2011) p83-84
companies which are financed by multi-banks syndicated loans. The main idea of this private solution is similar to a court-supervised insolvency proceeding. A typical London approach agreement comprises components such as a standstill period, coordination between parties, information exchange and refinancing plan.\textsuperscript{643} The Bank of England monitors and deters the non-cooperative opportunist behaviours of the other banks in a syndicate loan.\textsuperscript{644}

The London approach first contains a standstill period for the banks not to take individual actions against the debtors, and second it contains a negotiation stage organized by debtor’s leading bank to strike a restructuring plan.\textsuperscript{645} The viability of the London approach heavily relies on the support of lending banks, information sharing, financing approval from coordinated creditors, and apportioning cost and benefits among all parties.\textsuperscript{646} The success of the London approach depends on a leading bank organizing the whole restructuring procedure and a small number of creditors.

However, this requirement for success contrasts with the reality. Many financial creditors actively provide credit with different motives.\textsuperscript{647} Also, an increasing use of other sources of finance such as bonds along with the syndicated bank loan makes it difficult to find out dominant leading banks in the cases of private restructuring of large companies. Therefore, the London approach is facing significant challenges by the fragmented categories of debts and creditors. The transaction costs increase due to the rise of the categories of debts and creditors. Also, serious conflicts of interests among creditors create hold-out issues that make consensual agreement more and more difficult to achieve.

\textsuperscript{645}ibid p35
\textsuperscript{646}Finch Vanessa, ‘Corporate rescue in a world of debt’ (2008) Journal of business law p8
\textsuperscript{647}ibid p3
To sum up, cross-border insolvency of MCGs may be resolved by means of private restructuring. However, in the case where there are so many creditors with different motivations, it is a challenging task to organize such restructuring. Court-supervised insolvency proceedings, though arguably expensive, provide useful legal tools to overcome the opportunism of each party involved and more transparent information to all the creditors and a lower threshold of approval standards. For the purpose of a successful rescue, sometimes creditors have to implement a private negotiation by mixing with legal tools. The next section will examine hybrid solutions.

4.4 Hybrid solutions to corporate groups

As above mentioned, market solutions face serious limitations such as hold-out problems. With the acknowledgement of the difficulties of solely relying on private solutions for group rescue, debtors and creditors have developed hybrid solutions to resolve cross-border group restructuring issues. Hybrid solutions are the middle field between formal insolvency proceedings and informal contractual solutions. Unlike formal rescue such as administration and CVA, hybrid rescue measures have the characteristics of no court involvement or a minimum court involvement. The informal solutions are done mainly by private contracts, while hybrid ones may be facilitated by insolvency law related tools/procedures such as UK schemes of arrangement and pre-packs.

The main purpose of hybrid group insolvency solutions is to preserve the group going concern value either by incentivising creditors to renegotiate their loan agreement so as to

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649 Though Schemes of arrangement are categorized as company law tools, creditors schemes are frequently used in insolvency context. In this thesis, hybrid legal solutions mean the solutions that contain a mix of contractual solutions and legal solutions.
avoid a group-wide insolvency\textsuperscript{650} or to sell the whole group to the newly formed companies owned by senior creditors at the holding companies level.

4.4.1 Renegotiation of debt agreements at holding companies level

For the purpose of preserve group going concern value, a useful way is to renegotiate the debt contracts. Where the debts of the groups of companies are mainly incurred at the holding companies level, it is possible to avoid a potential group insolvency by reaching a new agreement between debtor holding companies and their creditors. If one debt agreement includes a majority voting clause which allows certain debts to be modified without the approval of all relevant creditors, the hold-out issue is not serious in this case. However, in practice, only in complex leveraged loan agreement can one find such clause.\textsuperscript{651} To facilitate reaching such a new agreement, certain legal tools with cram down functions are necessary in this regard.

UK schemes of arrangement can be viewed as useful tools to encourage dissident senior creditors accepting a new deal with debtors by a cram-down mechanism.\textsuperscript{652} In essence, schemes of arrangement could be considered as a compromise made between the company as one party, and the creditors or members as another party. ‘Sufficient connection’ is a jurisdictional standard of companies to use schemes. Generally speaking, as long as the loan contracts between the debtors and the creditors are subject to English law, the sufficient connection test is met.\textsuperscript{653}

\textsuperscript{650} The debtor may choose to renegotiate with existing creditors for debt waivers, or be provided means to sell the assets free of liens to creditors, or be provided means to offer new creditor super-priority to refinance debts. Kenneth Ayotte & David A. Skeel Jr. ‘Bankruptcy Law as a Liquidity Provider’ 80 U. Chi. L. Rev. 1557 (2013) p1573-1579.

\textsuperscript{651} Chris Howard and Bob Hedge, Restructuring law and practice Second edition LNUK (2014) p337

\textsuperscript{652} Re Rodenstock GmbH [2011]EWHC 1104 (Ch)
There are three main stages for a scheme to come into effect.\(^ {654}\) Firstly the company needs to apply to court to notice that a meeting will be convened; then creditors need to vote the plan and each class needs to approve it. The ensuing stage is for the court to sanction the plan.\(^ {655}\) One feature of schemes is their cram down power: as long as a majority in number of creditors (with 75 percent in value) in each class support a plan, the dissident creditors are bound by the terms.\(^ {656}\)

Schemes have the potential to deal with some debt restructurings involving cross-border groups of companies. When one group of companies meets financial distress, the main task of the schemes is to facilitate parties to reach a new deal, for example, by extension of the maturity date of the debts.\(^ {657}\) If the main borrower of the group is a holding company, the best way may be that a renegotiated deal could be made between the holding company and the senior creditors. The benefit is that there is no need to worry that multiple local insolvency proceedings are opened. The value of the group can be protected as the operating subsidiaries are not disturbed. For example, the new arrangement could include: issuing new shares to provide necessary funds for the group, conducting a debt-for-shares swap to settle part of the due claims, or converting the lower ranked debt to higher ranked debt in exchange for extension of debt maturity or waivers.\(^ {658}\) Also, these schemes respect the expectation of those financial creditors as they may draft contracts beforehand of lending which prescribes how to control the business and how to distribute the value.

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\(^{654}\) David Milman, ‘Schemes of arrangement and other restructuring regimes under UK company law in context’ Co. L.N. (2011), 301, p1-4

\(^{655}\) ibid p1-4


\(^{657}\) Apcoa Parking (UK) Ltd, Re [2014] EWHC 997 (Ch);

\(^{658}\) Christian Pilkington, Schemes of Arrangement in Corporate Restructuring, (Sweet & Maxwell 2013) p151
The Primacom Holding GmbH case\(^{659}\) exemplifies a vivid cram down scheme case\(^{660}\) where a potential corporate group insolvency can be avoided by using the UK scheme. In this case, the ultimate parent companies are two companies incorporated in Luxembourg. An intermediate company is Primacom which along with its subsidiaries operates mainly in Germany. In this case, most of the loan facilities were owed by Primacom, and the company could not serve its debt when they fell due. As a result, the company was of the opinion that debt restructuring could yield a better result than the German insolvency proceeding, so the company sought recourse to UK schemes on the basis that its financial documents were governed by UK law.\(^{661}\) The scheme helped the company and its creditors to renegotiate debts.

The scheme provided new liquidity and deleveraged the group. Notably, the debts of the operating companies were novated to the holding company so that the German directors' duty under German insolvency law requiring directors to file an insolvency petition when the company cannot pay the debt could be avoided.\(^{662}\) One important part of the deal was that Primacom's parent company agreed to take on certain debt so that Primacom would not be forced into a German insolvency proceeding. The flexibility of the private restructuring solutions provided useful tools to support such planning, and debt renegotiation. As a result, a potential cross-border insolvency of a group of companies could be resolved in only one jurisdiction.

The La Seda case\(^{663}\) is another example. The company La Seda, is the Spanish parent company in the group whose main business is packaging substance manufacturing across EU. The scheme was used to amend senior debts governed by English law with a UK

\(^{659}\)Primacom Holding GmbH v A Group of the Senior Lenders & Credit Agricole, [2011] EWHC 3746 (Ch) [2013] B.C.C. 201

\(^{660}\)The cram down schemes mean the schemes are used to cram down junior financial creditors so that hold out issued could be mitigated.

\(^{661}\)Primacom Holding GmbH v A Group of the Senior Lenders & Credit Agricole, [2011] EWHC 3746 (Ch) [2013] B.C.C. 201 p2

\(^{662}\)German directors have to file for insolvency petition within 21 days since the insolvency situation has appeared. ibid p9

\(^{663}\)Re: La Seda De Barcelona Sa [2010] EWHC 1364 (Ch)
La Seda was the borrower of senior facilities which were guaranteed and secured by most of the group members with their shares. The purpose of the restructuring was to inject new money into the group such that the group would not fall into fragmented insolvency proceedings in member states. As a result, the restructuring gave senior creditors more than 69% recovery, as opposed to insolvency which would have given senior creditors less than 40% recovery. The group used the UK scheme to cram down the dissident minority of senior creditors. The restructuring plan included, among other things, agreements which amended the terms of the senior loan facilities with senior creditors and added more group members to be the guarantors to the senior loan facilities.

All these cases show that when the debt contracts which cause the MCGs distressed can be renegotiated, the group can be kept intact. As a result, it is likely that the group going concern value is also preserved as the operating subsidiaries can be isolated to the restructuring process. Financial creditors may renegotiate contracts in accord with the terms of inter-creditor agreements. This provides certainty to them as well, as the terms are accepted by them when they decided to lend money. However, this option is more likely to be available in concentrated syndicated loan cases. Therefore, one may not assume that all cross border insolvency cases involving MCGs can be resolved in this way.

4.4.2 Group pre-pack sale

Another way to preserve the going concern value of a group is to conduct a pre-pack sale of the whole group to new companies formed by senior creditors of the group. Along with the sale, operating companies are still largely intact, and the junior creditors will bear the most loss due to their ranking. Inter-creditor agreements prescribe the priority and

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664 Re: La Seda De Barcelona Sa [2010] EWHC 1364 (Ch) p1
665 European debt restructuring handbook: leading case studies from the post-Lehman cycle 2013 p105
666 ibid p108
667 La Seda de Barcelona SA, re [2010] EWHC 1364 (CH)
enforcement sale methods amongst financial creditors in an out-of-court fashion.\textsuperscript{668} Such sale may happen at the intermediate holding companies' level so that the group will 'break the neck' and transfer the main assets-operating subsidiaries to the senior creditors.

In many cases, with the help of the contracts and restructuring laws, holding companies could sell the shares of the whole operating subsidiaries to the senior creditors without the claims from junior creditors, provided that junior creditors have security and guarantee given by the operating subsidiaries. Taking UK law as an example, the above aim could be done by a transfer scheme and inter-creditor agreement. Transfer schemes allow shares or assets of the operating group to be sold to companies formed by senior creditors while leaving out-of-money creditors behind against the assets-stripped holding companies. Junior creditors’ claims are released by the inter-creditor agreement so that they will not benefit from the assets of the newly formed companies.\textsuperscript{669} The aim of the transfer schemes is twofold: one is to cram down unsupportive senior creditors’ holdout issues, another is to allow the new company to be clear of debt from out-of-money creditors so as to avoid insolvency.\textsuperscript{670}

The reason why the junior claims could be legally released is because of the inter-creditor agreement, whereby the priority and enforcement method of financial creditors are regulated by provisions in it; one example of the term is as follows:

‘(a) the Junior Note-holders may not take any action to enforce their rights while the Senior Liabilities remain outstanding;

(b) the Secured Parties have no independent power to enforce or have recourse to any of the Transaction Security, or to exercise any rights or powers with respect thereto, except

\textsuperscript{669}Christian Pilkington, Schemes of Arrangement in Corporate Restructuring, (Sweet & Maxwell 2013) p19
\textsuperscript{670}ibid p19
The fundamental result that an inter-creditor agreement would like to achieve is that the claims, guarantee and security of junior creditors who, by the evidence of valuation, have no economic interests in the corporate group are released along with the security enforcement instructed by the senior creditors. As a result, the senior creditors could maximize the value of the corporate group as it is free of claims and encumbered assets from the junior creditors; it is not unusual that the terms of inter-creditor agreement put the right of control of enforcement in the hand of senior creditors by constraining the junior creditors' rights of enforcement. For example, in a European mezzanine inter-creditor agreement, the release provisions provide that junior creditors’ security and guarantee are automatically released if the senior creditors have instructed the agent to release their security on the debtor’s assets in accordance with the senior and second-lien facilities.

This is to say that the debtor in the restructuring, could sell the whole group encumbered by the security and guarantee of all financial creditors to the Newco formed by the senior creditors free of encumbrment. It has been expounded in the Barclays Bank Plc v HHY Luxembourg Sàrl case that the operational subsidiaries could be sold to the senior creditors as a whole by a sale of shares in the holding companies, with all the guarantee and security on the assets of subsidiaries released on the basis of release provisions in the inter-creditor agreement between senior financial creditors and junior financial creditors.

671 In the Matter of Christophorus 3 Limited, [2014] EWHC 1162 (Ch) P3
673 Ibid p48
IMO car wash case is a good example of a pre-pack sale of an insolvent MNC. IMO is the world's largest car wash company group based in the EU across fourteen countries. The group was funded by one senior facility agreement and one mezzanine facility agreement. When the group was in financial difficulties, it decided to transfer the business to Newcos owned by senior creditors with shares apportioned by them. Three of the main holding companies were put in administration to sell the business to the Newcos. The claims of the mezzanine creditors against the subsidiaries of the group were released by the security agent in accord with the inter-creditor agreement. As a consequence, the group was transferred to the senior creditors and the going concern value was preserved.

The European Directories case followed the similar path. The European Directories Group had business in night EU member states, and it used a pre-pack sale of one holding company’s share in one intermediate holding company called DH 7. The fact of this case was that DH 6 and DH 7 were companies incorporated in Netherlands. One intermediate holding company DH6 owned shares of another intermediate DH7 which in turn owned shares in the operating subsidiaries in the group. DH6 sold the shares in the intermediate holding company DH7 that sat below it. As a result, the whole operating subsidiaries in the insolvent MNC is sold to senior creditors. As the operating subsidiaries were kept intact, the group going concern value were preserved. The inter-creditor allowed the junior claims to be released on enforcement action by senior creditors.

4.5 Limitations of market/hybrid solutions

The above practice provides examples of the complex restructuring world in which

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677 ibid; Kon Asimacopoulos and Justin Bickle, European Debt Restructuring Handbook: Leading Case Studies from the Post-Lehman Cycle, (Globe Law and Business 2013) p26
678 HHY Luxembourg S.A.R.L &Anr v Barclays Bank PLC &Ors [2010] EWHC 2406
corporate group going concern value can be preserved by renegotiating debt agreements or a group pre-pack sale. However, it does not mean that every distressed group could find a similar way to avoid group insolvency proceedings or carry out a pre-pack sale. The merits of the restructuring practice should be acknowledged, whereas on the other hand, their limitation should also be seen.

4.5.1 Limitation of renegotiation of debt agreements at the level of holding companies

Every private debt restructuring case is almost a unique case, due to the different features of different companies and different capital structures. The unique characteristics of one group may make it difficult for other distressed groups of companies to follow the same path.

Though market solutions and hybrid solutions may be able to preserve the going concern value of MCGs by renegotiation of debt agreements at the level of holding companies, one cannot expect new agreements can be reached in all cross-border insolvency cases.

One important reason why an insolvent MNC can be rescued without triggering the opening of multiple insolvency proceedings in different member states is due to inter-creditor agreements. If senior creditors of the distressed cross-border corporate groups agree on the terms of pre-pack sales of the whole corporate group, junior creditors’ rights are released by the inter-creditor agreements. The cram down power of schemes of arrangement or equivalents in other member states may encourage debtors’ and the seniors creditors’ renegotiation whereby they can accept a new agreement without the need of approval from all parties. The consequence is that the whole value of the MNC is transferred to the senior creditors as a means of repayment, as other creditors' rights in the
assets of subsidiaries are released by contracts.\textsuperscript{680} Therefore, the full-blown group-wide insolvency can be avoided by hybrid solutions in the jurisdiction of holding companies; also the going concern value of the MNC is preserved as the relationships among operating subsidiaries are kept intact. An obvious limitation is that in the absence of such inter-creditor agreements, junior creditors' rights cannot be wiped out contractually. This may happen in the case where the profiles of creditors in different subsidiaries are non-identical so that no inter-creditors agreements bind them.

Schemes are well designed to modify long-term contractual obligations in financial contracts at the holding companies level,\textsuperscript{681} while they cannot modify employees' rights or tort creditors' rights at the operating subsidiaries level. One reason is that schemes are compromises and arrangements between one company and its shareholders or creditors; therefore, the scheme of the parent company cannot be used to modify other companies' creditors. It is true if the profiles of creditors in parent companies and those in the subsidiaries are different, and creditors are subject to different debt instruments in different companies.\textsuperscript{682} Without contracts such as inter-creditors agreements to bind all of these creditors regarding who has control and how to distribute loss among senior and junior creditors if the group goes wound up, the schemes of the parent company generally cannot modify other subsidiaries' creditors' rights without their consent.

Also, as these rights are non-contractual rights or mandatory rights shaped by foreign countries' policies, so it is difficult for schemes to change them. That is to say, the cram down power of schemes is ill-equipped to force foreign trade creditors or employees to accept a new deal.

\textsuperscript{682} Horst Eidenmüller, 'Comparative Corporate Insolvency Law' (2016) European Corporate Governance Institute (ECGI) - Law Working Paper No. 319 p27
Last but not least, UK courts also need to have jurisdiction to sanction schemes. If the foreign subsidiaries have CoMI and registered places in other member states and the debt agreements are also subject to the law of other member states, it would be almost impossible for the UK courts to sanction the schemes without sufficient connection between the foreign subsidiaries and the UK. To make use of English schemes of arrangement, some foreign creditors may conduct forum shopping. Forum shopping, as discussed in the previous chapter, may give rise to uncertainty to creditors.

The case of Re Magyar Telecom BV. 683 Magyar Telecom BV is a company incorporated in Netherlands but the business of the group is centred in Hungary. Its distressed situation may have caused the whole group to fall into fragmented formal insolvency proceedings in different countries, as the debts borrowed by the company were secured by the assets of most of the group members. 684 Since the company was registered in the Netherlands and because the notes are governed by New York law, it decided to move the CoMI of the company to the UK so as to use the schemes of arrangement. Ostensibly, the insolvency of corporate groups could be eased by reorganization of one financing company in the group, while creditors of debt instruments may expect US law or Dutch law would be the appropriate law rather than English schemes. Such uncertainty is costly as it may cause creditors to concern about risk of uncertainty.

Alternatively, the courts where the foreign subsidiaries are located should initiate their equivalent schemes to deal with the new agreement between those foreign companies and their respective creditors, and meanwhile seek cooperation with other courts. That is to say that a cooperation and coordination framework should be used in this regard.

683 Re Magyar Telecom BV, [2013] EWHC 3800 (Ch) p5
684 ibid
4.5.2 Problems with a group pre-pack sale

As with the limitation of renegotiation of debt agreements, a group pre-pack sale is also subject to similar constraints. The main purpose of group pre-pack sale is to wipe out the out of money creditors in the group, while supporting the senior creditors to own the main assets of the group-operating subsidiaries. A relatively simple and cheap way to do this is to transfer the shares that are held by one intermediate holding company in the operating subsidiaries to a new company owned by the senior creditors who are in the money. The result is that the debtor group repays the senior creditors by offering them the group going concern value—the operating subsidiaries, while the junior creditors' rights may be left against the holding companies or released according to the inter-creditor agreements.

Similarly, if creditors do not belong to one set of debt instruments, a pre-pack sale at the holding companies' level cannot achieve the aim of wiping out other creditors. Even though some senior creditors may obtain the shares of operating subsidiaries, the rights of other categories of creditors of operating subsidiaries have priority over the senior creditors as debts are superior to shares in insolvency. Such a pre-pack sale will carry other creditors' claims to the new company formed by the senior creditors, which makes the sale meaningless. The exception is that the senior creditors also enjoy secured rights and guarantees on the assets of subsidiaries and have priority over other creditors according to the terms of the inter-creditor agreement. Without the help from, for example, an inter-creditor agreement which contractually gives senior creditors power to release the rights of the other creditors, a pre-pack sale cannot leave those other creditors behind. It is also possible that the inter-creditor agreements do not allow certain debts to be released in a way favoured by the senior creditors, in such case, a pre-pack sale may be still
difficult to implement. The alternative solution may be to open more than one insolvency proceeding for different subsidiaries, in different jurisdictions, and sell the assets of subsidiaries to group buyers.

Another limitation of the group pre-pack sale arises from the drawbacks of the pre-pack sale itself. Pre-pack may be conducted for good reasons: no adequate sources of refinancing to support the protracted full administration; preventing damage of goodwill or retaining the key employees who are against insolvency. As one of the tools of hybrid restructurings, it purports to be more efficient than formal proceeding in the sense that it costs less and recovers more to creditors. However, certain evidence may not manifest this merit.

The quintessence of a typical pre-pack administration is that the negotiation of sale of almost all business or assets of the distressed companies is arranged before the appointment of administrators and the opening of administration proceedings. The function of the later-commenced administration proceedings is used as a tool to provide stay to all the creditors. However, the pre-pack sale is quickly done after the opening of administration proceedings.

Insolvency law grants voting rights to claimants in the creditors’ meetings who enjoy residual interests in the insolvent companies. Unsecured creditors are the only creditors allowed to vote on the administrators’ plan, while one caveat is that administrators can skip the creditors’ meetings if they are sure no value will break down into the unsecured

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685 Re Hellas Telecommunications[2009] EWHC 3199 (Ch)
686 Rebecca Parry Corporate rescue (Thomson Sweet & Maxwell 2008) p16
creditors’ class.  

In the Insolvency act 1986, Sch. B1 administrators' general power is endowed broadly on behalf of company's interest: 'The administrator of a company may do anything necessary or expedient for the management of the affairs, business and property of the company.'

According to Sch. B1 para 53-55, administrators are accountable to the creditors' meetings. The creditors' meeting will consider the administrator's plan, and approve it with or without modification. Also, the creditors' meeting has the power to dismiss the plan, thereafter the court may make order where it finds fit. Furthermore, the administrator's request to revise the plan after it has been approved in the last meeting will result in another creditors' meeting. Generally, the administrator of one insolvent company has a duty to invite creditors to join the initial creditors' meeting under para 51(1) of the Insolvency Act, and the administrator should present his reorganization plan to the creditors' meeting.

However, if the administrator believes that all the creditors will be fully compensated, due to the adequate assets of the distressed company or that other than the prescribed part of distribution to unsecured creditors, unsecured creditors have nothing more to receive.

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689 Insolvency Act 1986 Sch. B1 para 59(1)
690 Ibid para 53(1)
691 Ibid para 55(2)
692 Ibid para 54(2)
693 Ibid para 51 (1)
694 See insolvency act 1986 176A Share of assets for unsecured creditors

(2) The liquidator, administrator or receiver—
(a) shall make a prescribed part of the company’s net property available for the satisfaction of unsecured debts, and
(b) shall not distribute that part to the proprietor of a floating charge except in so far as it exceeds the amount required for the satisfaction of unsecured debts.

(3) Subsection (2) shall not apply to a company if—
(a) the company’s net property is less than the prescribed minimum, and
(b) the liquidator, administrator or receiver thinks that the cost of making a distribution to unsecured creditors would be disproportionate to the benefits.'
the company cannot be saved as a going concern for the benefit of general creditors, the administrator may not commence the creditors' meeting. This confers administrators the capacity to conduct the business or make decisions without the creditors meetings.

Para 68 goes on to provide that the administrators should manage business according to the approved or revised proposal; the court only gives instruction to administrators where no proposal is approved or where they think it is appropriate to do so. However, in practice, even if the administrator believes that there may be interests for unsecured creditors in some cases, he can still use his power to sell the assets of the company. This power has been affirmed by the case Re Trans Bus International Ltd. Such efficiency comes from the fact that the Enterprise act 2002 aims to reduce the courts' involvement in cases where the meetings of creditors are unnecessary; without such new rules, administrators cannot make any decisions in the period of administration without the approval of courts. Similar to UK rules, US bankruptcy code 363(b) also provides convenience for the application of a pre-pack sale: after a notice and hearing, the debtor in possession has power to sell all its assets without meeting other requirements of confirmation of a normal chapter 11 plan. Similar to its counterpart of the UK pre-pack, there is no need to get unsecured creditors’ approval.

Therefore, administrators generally have power to sell the company's assets without the approval of creditors' meetings and orders from courts. As a result, it is difficult for the

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695 Insolvency Act 1986 B1 para 52(1)
696 Insolvency Act B1 para 68
698 Re Transbus International Ltd [2004] EWHC 932 (Ch) Chancery Division
699 Ibid.
701 Ibid p262
unsecured creditors to have sufficient information regarding whether their rights are infringed.

In fact, arguably, the unsecured creditors in a given pre-pack sale are most likely to be the victims in that administrators may skip notice to them or approval from them. Where the assets are sold to the existing management team, such pre-pack may be dubious to unsecured creditors as it is very likely that only the senior creditors are paid off in exchange for further finance support to the Newco established by the existing teams while leaving nothing to unsecured creditors.

The statement of insolvency practice 16 is designed to confer more protection to unsecured creditors by requiring administrators to disclose their background of appointment; to provide explanation to unsecured creditors regarding the justifications of pre-pack sales; to answer why pre-pack sales are the best results for all creditors. However, this design alone cannot thoroughly eliminate all the problems in practice, as the administrators are more likely to follow the instructions of senior creditors or directors but not unsecured creditors.

As a result, pre-pack sales may be rigged by the senior creditors and it may not necessarily maximize the value of the distressed groups of companies. Even though

705 Bo Xie, ‘Protecting the interests of general unsecured creditors in pre-packs: the implication and implementation of SIP 16’ (2010) Company lawyer p6
706 One empirical research shows that the performance of pre-pack in terms of general recovery rate for creditors in general only engenders a marginal improvement (22%) vis-a-vis non-pre-pack business sale (21.8%) in administration or administrative receivership. Pre-pack’s recovery rate for preferential creditors is only 13%, compared to non-pre-pack recovery rate 38%. Pre-pack recovery rate for unsecured creditors is 1% which is worse than non-pre-pack recovery rate 3%. Sandra Frisby, 'Report to The Association of Business Recovery Professionals A preliminary analysis of pre-packaged administrations’ August 2007 p50, p56; In an empirical study done by Professor LoPucki, there is only one buyer in more than half of the pre-pack cases. The lucrative bonuses of bankers make them indifferent to achieving as high a price as possible. They actually may prefer a lower price to the only buyer in exchange for his payback in the future. Lyn M.
pre-pack may reduce the cost of long and complex administration fees, the price sold may be significantly lower in comparison to the value of one business after reorganization (only the latter’s 50%).\textsuperscript{707} The unsecured creditors are unlikely to provide their own restructuring plan, for example, they cannot financially afford valuation fees.\textsuperscript{708} Delay and cost arising from the challenge of unsecured creditors are something courts try to avoid, which in return increases the difficulty of challenging plans in favour of debtors or senior creditors.\textsuperscript{709}

Arguably, one assertion could be made that at least pre-pack may not significantly increase the overall return to all the creditors, but it is suspected of transferring wealth from the preferential and unsecured creditors to secured creditors.\textsuperscript{710} Secured creditors, existing management teams and professional advisors have the inclination to use a pre-pack sale as they can benefit most from it.\textsuperscript{711}

To sum up, though the market and hybrid solutions may prevent the insolvency of MCGs or preserve the going concern value of MCGs in some cases, they are not always available. The uncertainty and the abuse from pre-pack mean market/hybrid solutions are not always reliable solutions to preserve the corporate groups’ going concern value.

4.6. Cooperation and coordination under protocols

After understanding that it is not always possible to resolve the group insolvency in one

\hspace{1cm} Lopucki, Joseph. w. Doherty 'Bankruptcy fire sales' (2007) UCLA School of Law Law& Economics Research Paper Series Research Paper No. 07-07 p35
\hspace{1cm} \textsuperscript{707} Lopucki found in his study, larger companies only get their 35% book value in a pre-pack sale, while get 80% of their book value in reorganisation. See Lyn M. Lopucki, Joseph. w. Doherty 'Bankruptcy fire sales' (2007) UCLA School of Law Law& Economics Research Paper Series Research Paper No. 07-07 p3
\hspace{1cm} \textsuperscript{708} ibid p38
\hspace{1cm} \textsuperscript{710} ibid p39
\hspace{1cm} \textsuperscript{711} Vanessa Finch, Corporate insolvency law perspectives and principles (Second Edition Cambridge university press 2009) p463
\hspace{1cm} \textsuperscript{713} Gerard McCormack, Corporate rescue law--an Anglo-American perspective, (Edward Elgar Publishing Limited UK 2008), p73
jurisdiction, private parties may draft cross-border insolvency agreements to facilitate the group insolvency. The protocol is a typical form of cooperation between courts of different jurisdictions and insolvency practitioners.

Protocols may be used as useful tools dealing with cross-border insolvency cases. The nature of protocols is ad hoc agreements reached by private parties and supported by courts. The aim of protocols is to build up a framework of cooperation and communication in the context of multiple insolvency proceedings. The provisions of protocols could reflect the international guidelines on cooperation and coordination in cross-border cases. Useful guidelines include the Concordats by the International Bar Association, Guidelines applicable to courts to courts communications in cross-border cases by American Law Institute, ALI's Principles of Cooperation Among the NAFTA Countries, Global principles for cooperation in international insolvency cases, the European Communication and Cooperation Guidelines for Cross-border Insolvency by two European professors, UNCITRAL Legislative Guide by UNCITRAL Working group V.

In the Maxwell case one protocol between the US and the UK played a groundbreaking role in the history of protocol. Both jurisdictions decided to open the insolvency proceedings. The innovative aspect in this case was that unprecedented cooperation was conducted by means of protocol. This protocol, on the one hand, respected the jurisdiction of the US and the UK courts, on the other hand, made the chapter 11

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713 Ibid p158
714 American law institute and International insolvenency institute, 'Transnational insolvency: Global principles for cooperation in international insolvenency cases’ 2012
716 Jay Lawrence Westbrook, 'The lesson of Maxwell communication (1996) 64(6) Fordham law review p2534
reorganization and UK administration very coherent and interdependent.

In some cases, the assets and administrative center of one company are not necessarily in one jurisdiction. Maxwell's CoMI is in the UK, while its principal assets are the US. Due to the sheer size of the assets, US court also claimed insolvency jurisdiction for Maxwell. The Maxwell case exemplified that a reorganization plan of a group of companies could in fact be done by cooperation of more than one court. What is in need is a framework of coordination among separate reorganization plans, connecting the different insolvency procedures together.

The recent Nortel case provides a good example regarding how two national courts can reach an agreement of sale of assets together and of proceeds allocation on the basis of corporate form irrespective of nationality and the location of certain assets.\textsuperscript{717}

The parent company of the Nortel and the Canadian wing of its subsidiaries filed insolvency proceedings in Canada, while the US subsidiaries filed insolvency proceedings in the US.\textsuperscript{718} The head office of the telecom giant Nortel is in Canada. It consists of many subsidiaries globally, but the business relationships among its subsidiaries is said to be integrated, especially with regard to research and cash management.\textsuperscript{719} The Canadian court and American court prioritized the task of selling the group as a whole, while leaving the allocation of proceeds to a later point so that the value of the group could be preserved.\textsuperscript{720}

\textsuperscript{717}In re Nortel Networks, Inc, 532 BR 494 Bankr D Del 2015
\textsuperscript{718}(Other companies in somewhere else do not enter into formal proceedings) John A. E. Pottow, ‘Two cheers for universalism: Nortel’s nifty novelty’ (2015) Public law and legal theory research paper series paper No.487 Michigan law journal. p335-336
\textsuperscript{719}Jay Lawrence Westbrook, ‘Nortel: the cross-border insolvency case of the century’ 2015 8 JIBFL 498 p2
The two national courts agreed to take a universalist view to consider the Nortel group. The courts gave weight to the legal status of each entity, but were not concerned so much with the location of one of the most valuable assets—the IP of Nortel located in Canada. The two courts agreed that no company in the group were entitled to claim the proceeds of sale of IP asset in full simply because it was fortuitously located in Canada but not somewhere else. The integrated characteristics of the Nortel group provide evidence that all the subsidiaries utilize the IP in their operation and contribute interests to the whole group; therefore, The IP assets should be allocated to group members in a pro rata fashion.

The limitations of protocols arise from their ad hoc contractual nature. Private protocols may not be drafted successfully by various debtors and creditors without their consent. Uncertainty may arise as creditors are not sure what terms will be concluded in the protocol to allocate powers of courts and insolvency practitioners and procedures of cooperation. Also, some courts may lack the ability to support the ad hoc protocols. It may be more desirable to have a formal legal framework that governs the cooperation and coordination. Also, it may be desirable to have one leading party facilitate the cooperation lest the otherwise chaotic situation will render the possible group rescue plan dissipated.

The limitations of the market/hybrid solutions and private protocols indicate that it is desirable to have a general framework for procedural coordination among insolvency courts of different jurisdictions. The next chapter will consider the group coordination proceedings prescribed by EIR recast 2015 and examine whether it fills in this gap.

723 Bob Wessels, ‘Cross border insolvency agreements: what are they and are they here to stay?’In Faber et al, (eds.) Insolventie en Overeenkomst, (Nijmegen, 2012). p11
724 ibid p11
Chapter 5 Group coordination proceedings and recommendations

Chapter 3 and Chapter 4 reveal that procedural consolidation, market/hybrid legal solutions and private protocols contain limitations and drawbacks as being the solutions for cross-border insolvency of MCGs. The limitations of the application of procedural consolidation and market solutions suggest that in some cases, cross-border insolvency of groups of companies needs to be resolved in more than one jurisdiction. Therefore, one may argue that a general framework for cooperation and coordination of multiple insolvency proceedings may be required in this aspect.

This chapter examines the third practical solution for the cross-border rescue of multinational corporate groups—group coordination proceedings in EIR recast. The new group coordination proceeding in EIR recast is the first cross-border insolvency rule which specifically deals with coordination issues among group member companies. It argues that a general cooperation and coordination legal framework provided by EIR recast is desirable as an alternative to procedural consolidation and market approaches in that such a framework provides certainty and possibility to preserve group going concern value. However, this framework is not without drawbacks. Among other things, the most obvious issue of group coordination proceedings is that individual companies which are part of the group can opt-out of group coordination proceedings. As a result, the utility of such a framework is doubtful.

The analysis around the drawbacks and the recommendation for improvement of the opt-out mechanism are original in the existing literature, as the EIR recast is a fairly new rule which has not yet come into effect. The discussion and analysis regarding the benefits and
recommendations of the opt-out mechanism constitute part of the originality of this thesis.

This chapter will first provide an overview of group coordination proceedings. Secondly, it analyses the ability of group coordination proceedings to preserve group going concern value with reference to its opt-out mechanism. The main concern is that certain senior creditors or investors of subsidiaries can gain control of the subsidiaries easily by means of providing refinancing or buying debt in the secondary debt market; they may opt out of the group coordination proceedings in their own interests. For example, they may conduct a quick pre-pack sale of some subsidiaries at undervalued prices without even considering the group rescue options. One may ascribe these undesirable possibilities to the inherent issues of legal tools such as pre-pack or refinancing tools. To mitigate these undesirable issues resulting from the differences in national insolvency laws, the possibility of harmonisation of insolvency law at the EU level will be discussed. The chapter reveals the obstacles of harmonisation.

At last, it offers a modest recommendation which works as a constraint on the invocation of the opt-out mechanism in group coordination proceedings by interpreting existing provisions in the EIR recast. It argues that insolvency practitioners of financially distressed companies in the same group should have an obligation to communicate to each other and consider a group rescue plan at an early stage along with their respective individual rescue options. It provides a discussion of the content of the obligation and explains why this obligation exists by interpretation of provisions in the EIR recast. Also, the chapter provides the benefits that can be obtained by this recommendation.

5.1 EIR group coordination proceedings
From a regulatory perspective, there are generally four approaches to be identified to regulate group insolvency law, which are substantive consolidation, procedural consolidation, procedural cooperation and ignoring the necessity of rules for group insolvency.\(^{725}\) EIR recast\(^ {726}\) (New EU regulation on insolvency proceeding 2015) does not take a huge leap towards adopting substantive or procedural consolidation.\(^ {727}\) Rather, it adopts a modest way by adding one group chapter into the EIR recast focusing on coordination and cooperation among practitioners and courts. The European formal group coordination proceeding does not exclude the possibility to use informal rescue options, while it serves as a parallel and general framework for parties to choose. The adoption of procedural cooperation is so far in line with the analysis of this thesis, as both substantive consolidation and procedural consolidation associated with serious uncertainty.

It may be helpful to organize a cross-border insolvency case involving groups of companies in a court-coordinated fashion, especially where private restructuring is not a possible option. Group coordination proceedings can be seen as an improvement compared to the previous version of EU regulation which consisted of nothing in regard to groups of companies.\(^ {728}\) In the new EU regulation on insolvency proceedings, besides previous general requirements for cooperation and communication between insolvency practitioners and courts, Chapter V prescribes specifically group coordination proceedings for cross-border insolvency of corporate groups.\(^ {729}\) The ultimate goal of this proceeding is to provide a group reorganization plan for the whole group so that the value of the group could be preserved in a desirable way.

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\(^{728}\) Reinhard Bork Renato Mangano, European cross-border insolvency law (OUP Oxford 2016) p291

\(^{729}\) EIR recast 2015 Chapter V
Chapter V retains the 'communication and cooperation obligations' of courts and insolvency practitioners. In the group context, to connect group members together by communication and cooperation is desirable. For example, by cooperation, information of other members could be obtained; it is also a very important pre-condition to a successful rescue.

What is more, Chapter V also provides a framework for the coordination of group corporate insolvency. To conduct a group-wide reorganization, a group coordination plan can be proposed by a coordinator appointed by any court in which the insolvency proceeding of one group member is opened; insolvency practitioners of different insolvent subsidiaries can also jointly decide an eligible court for the purpose of group coordination proceedings. All these efforts are made to facilitate multiple group insolvency proceedings such that these proceedings of member companies can be coordinated and a better result can be achieved. The key function of group coordination proceedings is to provide a platform for coordinators to consider recommendations and group coordination plans for the whole group. The group coordination plans are the fulcrum of the group coordination proceedings; one may imagine that relevant group member companies which join in the proceeding may decide to draft a coordinated recovery plan by extending debt maturity or selling group assets to repay debts.

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730 When insolvency practitioners of one group member believe that it would be better to liquidate the assets by a group restructuring plan, they may suggest such plan to other insolvency practitioners of other member companies under general cooperation and communication basis. see also Art 56 (2) (c) 'Insolvency practitioners shall consider whether possibilities exist for restructuring group members which are subject to insolvency proceedings and, if so, coordinate with regard to the proposal and negotiation of a coordinated restructuring plan.'

731 Chris Howard and Bob Hedger, Restructuring and law & practice, (LNUK 2014)

732 Art 72 (1)(b) 'The coordinator shall propose a group coordination plan that identifies, describes and recommends a comprehensive set of measures appropriate to an integrated approach to the resolution of the group members' insolvencies.'


734 EIR recast 2015 Art. 70

735 However, such plan should not include substantive consolidation as it may fundamentally change the creditors' pre-insolvency rights without justification. Gabriel Moss QC, Ian. Fletcher QC and Stuart Isaacs QC, The EU Regulation on insolvency proceedings (Third edition OUP 2016) p516
The coordinator has the power to arrange the multiple proceedings. To facilitate the group coordination proceeding, the coordinators also enjoy power such as to participate in any foreign hearing and creditors’ meetings, to present plans to the relevant creditors, or to make a stay on the insolvency proceedings which are subject to the group coordination proceedings. Such stay power may help to deal with the 'commons issues' where an individual company would like to pursue a different goal which may break up the group rescue plan. Coordinators therefore enjoy the power to make stay to resolve this problem either in the case of group reorganization aiming for recovery or a group sale of assets.

The group coordination proceedings cannot be employed to extract value from other subsidiaries to the parent companies or vice versa. A pre-condition on the court that decides to open group coordination proceedings is that none of the subsidiaries which join in the coordination proceeding is likely to be financially disadvantaged. The court should therefore conduct a preliminary cost and benefit analysis to convince it that the benefit is no less than the cost of such proceeding. Therefore, group coordination proceedings provide a more concrete framework where all the relevant insolvency practitioners and courts could reach a group-wide deal.

As a result, group coordination proceedings are welcome development as they provide a general group insolvency framework which not only has the potential to preserve the

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736 EIR recast Art.72 (2) e
737 EIR recast Art 72
738 Insolvency practitioners under EIR recast enjoy a general stay power which can be used if certain requirements are met, on other insolvency proceedings. One of the requirements is a reasonable chance of success; another is such stay benefit the member company on which the stay is imposed. Art 60 (j)(iii) New EU regulation. Coordinator' stay power may be invalid to certain group member companies if certain group members decided not to follow the group plan.
739 By contrast, without the opening of group coordination proceedings, the insolvency practitioner of one member companies can only make a stay on other insolvency proceedings only if a group wide sale is possible. See Art.60 (b) EU regulation. See also Gabriel Moss QC, Ian. Fletcher QC, Stuart Isaacs QC, The EU Regulation on insolvency proceedings (Third edition OUP 2016) p516
740 EIR recast Art 63(b)
741 See EIR recast Recital 58 and see also Reinhard Bork Renato Mangano, European cross-border insolvency law (OUP 2016) p294
group value, but can also provide certainty. The voluntary opt-out mechanism provides some certainty and flexibility to the group members. For example, if one subsidiary believes that the group plan is harmful to the creditors of it, the insolvency practitioners of this subsidiary could choose to opt-out of the group plan.

5.2 Problems of group coordination proceedings

Group coordination proceedings may have the potential ability to preserve the group going concern value, as they aim to connect the group members via one group coordination proceeding. The flip side is that the desire and effort to rescue the group may be dampened if an important group member which forms valuable relationships with other group member companies could voluntarily choose to opt-out of the group coordination proceedings without any limitations. The next section will focus on this opt-out mechanism.

5.2.1 Opt-out mechanism of group coordination proceedings

The group coordination proceedings can be objected to by the insolvency practitioners of any member companies, the consequence being that those member companies are unaffected by the group coordination proceedings. The opt-out mechanism has attracted criticism from some scholars and it is generally believed that the effectiveness of group coordination proceeding will therefore be negatively affected.

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742 Group coordination proceedings respect entity law, it does not pool the assets and claims of different group members together.
743 EIR recast Art.64
Since the cost of cooperation will be increased due to the incentives for hold-out, the cost of group coordination proceedings may outweigh the benefits they could bring to creditors.\footnote{Kristin Van Zwieten, ‘An introduction to the European Insolvency Regulation, as made and as recast’ R Bork and K van Zwieten (eds), Commentary on the European Insolvency Regulation (Oxford University Press 2016) p53} Also, rejection of inclusion has an automatic effect without any restrictions from the court which opens group coordination proceedings.\footnote{Gabriel Moss QC, Ian. Fletcher QC and Stuart Isaacs QC, The EU Regulation on insolvency proceedings (Third Edition OUP 2016) p510} Art 64 (3) also provides that such objection of inclusion could obtain the approval from the court where such dissident insolvency practitioners are appointed if it is required under the local insolvency law. In other words, if the local law does not require court approval, the opt-out is in the hands of the insolvency practitioners without scrutiny of courts.

The reason why group coordination proceedings include an opt-out mechanism for the insolvency practitioners is to avoid the potential coercive inclusion of any group members.\footnote{Jessica Schmidt, ‘Group insolvency under the EIR recast’ (2015) Eurofenix Autumn p18} The EIR is based on entity law, and therefore, each subsidiary's interests should be protected.\footnote{EU regulation on insolvency proceedings recast 2015, Recital 52, Cooperation between the insolvency practitioners should not run counter to the interests of the creditors in each of the proceedings, and such cooperation should be aimed at finding a solution that would leverage synergies across the group.} That is to say that the goal of preservation of group value should not trump the importance of creditors' protection of subsidiaries.

The above compromise leaves the non-binding group coordination proceeding as having low effectiveness, as the parties may simply choose not to coordinate.\footnote{Samantha Bewick, ‘The EU Insolvency Regulation, Revisited’ (2015) Int. Insolv. Rev. p17 see also Michael Weiss, ‘Bridge over Troubled Water: The Revised Insolvency Regulation’ (2015) Int. Insolv. Rev.} Nonetheless, the concern should not be overestimated. The opt-out itself is a protection to every single subsidiary especially in the case where the group going concern value is not large enough.
to cover the cost of cooperation so that the group plan will likely decrease the value of subsidiaries.

Supporting a group plan at the cost of subsidiaries takes issue with the rationale of limited liability which are well established.\textsuperscript{750} In the context of group insolvency, respecting each subsidiary is a basic requirement confirmed by the ECJ \textit{Eurofood} case\textsuperscript{751}. Also, the directors of the subsidiaries in fact have no obligations to other subsidiaries or creditors of those subsidiaries; directors only aim to achieve success for their own companies and creditors.\textsuperscript{752} Similarly, the office-holders such as administrators are agents of the companies and they only owe duties to the companies where they are appointed; administrators only promote the interests for creditors of the companies to which they are appointed.\textsuperscript{753} All these reasons support the opt-out mechanism.

However, a complete free opt-out option may ignore the possibility that in certain cases, such opt-out neither serves the interests of creditors of the hold-out subsidiaries, nor does it serve for the interests of creditors of the whole group. It is one thing that the insolvency practitioners of some companies would like to stay in the market by means of administration, while the administrators of other group members may prefer leaving the market by a sale of the business;\textsuperscript{754} but it is another thing that certain senior creditors of subsidiaries who have controlled the companies can choose to opt-out of the group plan while taking strategies that benefit only themselves. An example could be a pre-pack fire sale of the subsidiary irrespective of a better group plan which can benefit all the creditors. The latter cases are the main problems whereby they render the group rescue

\begin{itemize}
\item \textsuperscript{751} \textit{Eurofood} [2006] Ch.508
\item \textsuperscript{753} Sch. B1 para 3(2); see also Ian Fletcher, \textit{The law of insolvency}, (4th Edition Sweet & Maxwell London 2009) p568
\item \textsuperscript{754} Burkhard Hess, Paul Oberhammer, Thomas Pfeiffer, \textit{European insolvency law Heidelberg-Luxemburg-Vienna report} (Hart Publishing Oxford 2014) p222
\end{itemize}
plan vulnerable to the strategic actions of some creditors or investors. The next section will provide a further discussion on this issue. The discussion of problems of opt-out mechanisms in the context of creditors’ control literature forms part of the originality of this thesis.

5.2.2 Creditors’ control and its implication on group coordination proceedings

Group coordination proceedings do not necessarily deal with a free fall insolvency of groups of companies where all the group members enter into group proceedings in different member states. As in many group cases financing is arranged at the parent companies’ level, group insolvency cases may in fact only involve one or more holding companies. Also, the subsidiaries in one group may have the same creditors who are bound by one set of loan documents sitting at the level of holding companies. It is possible to argue that in these cases, certain creditors will not be able to take individual action to control one single subsidiary as they are all bound by one inter-creditor agreement.

However, this is not always the case. It is possible that member companies in one group have different profiles of senior creditors; it is also possible that certain investors become creditors of subsidiaries later via buying debts at distressed debt market. In the latter cases, creditors or investors may not aim to preserve the group going concern value; rather, they may try to control the valuable subsidiaries simply because their value is underestimated. Allowing these creditors to invoke opt-out mechanism freely will make the goal of preservation the group going concern value difficult to achieve. Their inconsistent strategies may not only cut off the relationships of group members

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755 Isabel Giancristofano, ‘Third party securities in the financial restructuring of corporate groups In Germany. (2016) International corporate rescue 13(2) p111
756 These holding companies may deal with financial creditors in a package of loan documents and on-lend money to subsidiaries. see Antony Zacaroli QC, Alexander Riddiford, ‘Schemes of arrangement and chapter 11 of US bankruptcy code: a comparative view’ (2015) South square digest p2
757 Proposals for the revision of the European Insolvency Regulation – a step forward in the rescue culture? Linklaters 2012 p4
companies in the MCGs, but also create uncertainty to stakeholders. This section first provides an overview of creditors' control on the debt restructuring practice. Then it moves to discuss the implication on the group coordination proceedings.

5.2.2.1 Senior creditors' control

Senior creditors or investors could gain control via providing refinancing or buy cheaper debt in the secondary debt market. These senior creditors therefore could, to some extent, influence the debt restructuring plan.\(^{758}\) It is entirely possible that the senior creditors could expect a sale of business to other buyers or own it by themselves.\(^{759}\)

Refinancing terms frequently constitute the main provisions of the reorganization plan. As the value of the cash-starved companies can only be kept when the company is operating, refinancing enables the companies to make payment to employees and trader creditors of operating subsidiaries. The protection of the new money provided after the opening of insolvency proceedings will be granted priority to most of pre-insolvency debts or at least enjoy the same priority status with some secured debt.\(^{760}\) By providing refinancing, the creditors may gain bargaining power over cash starved companies so that the creditors may in fact force debtors to extract value from other creditors to the ones who provide new money. Refinancing should be encouraged to the extent that such new money could create new value; it should not be used as a tool to redistribute value.\(^{761}\)

 Certain types of refinancing terms and practice may not bring in value to the debtors' insolvency estate; rather they may lead to value redistribution: roll-up and cross-

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\(^{759}\) ibid p1158

\(^{760}\) Oscar Couwenberg, Stephen J. Lubben, 'Essential Corporate Bankruptcy Law' (2013) University of Groningen Faculty of Law Research Paper Series No. 04 p8-9 p15

collateralization. Roll-up describes the situation where certain lenders' pre-insolvency unsecured debts transform into part of the post-insolvency debts so that all the debts of the lenders enjoy priority over other creditors. Cross-collateralization happens where the lenders have pre-insolvency debts which are full secured. As a result, the lenders require that the post-insolvency assets must be used to secure their pre-insolvency debts as well. In other words, the pre-insolvency unsecured debts start to enjoy priority over other creditors due to the cross-collateralization clause. The overall effect of these refinancing methods is to exploit unsecured creditors and preferential creditors who would have ranked higher or pari passu with the lenders' unsecured pre-insolvency debts.

Courts and court appointed monitors need to hold refinancing in check; the purpose is to prevent refinancing becoming the power to redistribute value from junior creditors to senior creditors.

Another thing that may happen may be that certain investors have the incentives to control or own the subsidiaries in their own interests. These creditors or investors may achieve this aim by exerting loan-to-own strategies in the debt market. The result would be that certain subsidiaries are pulled out of the group coordination proceeding. This is because that the investors may believe that it is the subsidiaries rather than the whole group that they want to purchase. For example, if one foreign subsidiary plays very important R&D functions in the group, the investors or local senior creditors may want to absorb it into their own groups. However, it does not mean that the buyers can use the

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764 Some countries' refinancing rules may work well to avoid roll-up or cross collateralization. For example, the UK insolvency act 1986 provided that the contract entered into by administrator would enjoy priority to administrators' remuneration and floating charge. Therefore, it is clear that senior creditors who advance post-insolvency financing cannot assert that their pre-insolvency unsecured debts can enjoy any priority as their pre-insolvency loans are simply not the debts incurred by the administrators. See Insolvency Act 1986 B1 99, Gerard McCormack, 'Super-priority new financing and corporate rescue' (2007) Journal of Business Law p13

assets of the subsidiary in a more efficient way than the distressed group. Also, without the subsidiary, other group members in the distressed MCG may lack going concern value as they rely on the relationships with the subsidiary.

Also, it could be the case that some investors who are only interested in short-term profit, such as many hedge funds, believe that one subsidiary is undervalued and they would like to buy low and sell high later. They may opt out the group rescue option straightaway. As a result, the rescue of the subsidiaries is arranged following these investors’ preferred track.

All these examples show that group coordination proceedings should put a limitation on the use of opt-out mechanism, as creditors of the distressed MCGs may not necessarily organized by concentrated contracts. Senior creditors may gain control and use the opt-out mechanism to pursue their own interests. The next section will provide more discussion on this issue.

5.2.2.2 Implication on group coordination proceedings

No matter which way creditors could gain control of the subsidiaries, the most important implication on group coordination proceedings may be that local senior creditors or investors of subsidiaries may have their own reorganization plans which are different from the group plan provided by the coordinator. The group plan and subsidiaries' plans may clash with each other. The key is to decide which one the local insolvency practitioner should pursue.
Senior creditors’ control could be a good thing for several reasons. The competition of senior creditors for control can reveal the value of the corporate group.\textsuperscript{766} For example, if the corporate group is worth more as a whole than in pieces, senior creditors may try to maintain the integrity of the group assets to achieve maximum recovery.

Also, that competition for control by buying debts may help concentrate the fragmented debts; it reduces the intensity of holdout issues. The creditors who try to exert the loan-to-own strategies will also want to buy debts at the below par price to control the restructuring or insolvency process, in the hope of reaping the undervalued asset prices. This debt trading practice will transform the fragmented debts into the hands of senior creditors who have informational advantages. The senior creditors are therefore in a better position to make decisions regarding how to rescue the distressed group.

What is equally important is that in the refinancing cases, by injecting money to finance certain members in the group, the insolvency issue could be avoided.\textsuperscript{767} Refinancing is therefore a useful method of insolvency planning, and it could decide which companies should be put in insolvency proceedings. Financial creditors can use financing contracts to gain control of the distressed companies when the companies reach the vicinity of insolvency.\textsuperscript{768} Such control may bring in the benefit of better decision-making due to certain creditors' information advantages.\textsuperscript{769}

After all, whether the group should be rescued or whether the assets should be put together is a commercial judgment, which depends on whether or not there is group going

\begin{itemize}
  \item \textsuperscript{766}The modern financial contracts are very carefully drafted such that the creditors who are in the best position to make decisions obtain power to make business judgment. in the US, the most likely DIP lenders are the companies’ existing lenders as they have the best information regarding the value of the companies. David A. Skeel, Jr, ‘The past, present and future of debtor-in-possession financing’ (2003-2004) 25 Cardozo L. Rev. 1905 p1917
  \item \textsuperscript{767}Assume that a cross-default will make the whole group enter into fragmented insolvency proceedings. If the group could borrow money at the whole enterprise value, the new money could help the group to preserve the value and such solution benefits all the creditor. Gregor Baer and Karen O’Flynn, 'Financing Company Group Restructurings book review’ (2016) Insolvency and Restructuring International Vol 10 No 1 p37
  \item \textsuperscript{768}Douglas G. Baird& Robert K. Rasmussen 'Private debt and the missing lever of corporate governance’ (2005-2006)154 U. Pa. L. Rev. 1209 p1217
  \item \textsuperscript{769}ibid p1219
\end{itemize}
concern value. Such decision is better to allow the creditors and the debtors who have the information to decide.

Nonetheless, problems may arise in that local senior creditors may also choose not to support the beneficial group plan; yet they choose to take advantage of the insolvency laws to enrich themselves. In other words, it is possible that creditors' power to exert control may be abused by senior creditors to extract value from creditors in general. The desirable group plan may not be considered even if the group plan is better to serve creditors' interest in general. As a result, the group going concern value may be lost.

Since creditors of different subsidiaries may be of various profiles, they may not be bound collectively by one debt instrument. One possibility is that certain senior creditors of the subsidiaries would like to conduct a pre-pack sale of the subsidiaries for a quick return. If so, they may have no incentive to follow the group coordination proceeding even though such participation will benefit the other creditors of subsidiaries. As one professor in the US has argued, Chapter 11 of the US bankruptcy law has been a vehicle which is used not so much as a tool for resolving the 'commons' issues as for leaving the junior creditors behind.\textsuperscript{770} DIP lenders may abuse their power to require debtors to conduct a fire sale of the business as a pre-requisite of financial support.\textsuperscript{771} These creditors' power should not be used unscrupulously and such power requires examination by courts or monitors. Among other things, one important job the courts need to do is to examine whether the refinancing lenders try to inappropriately improve their unsecured part of debts by exerting their bargaining power.\textsuperscript{772}

All these problems are not group specific issues. They are in fact the shortcomings of refinancing mechanisms and pre-pack mechanisms. However, these mechanisms are part of insolvency law which, if applied properly, have significant value. For example, refinancing options can resolve the insolvency-specific issue—debt overhang. The distressed companies may be so deeply in debt distress that they cannot invest in efficient investment to trade out of insolvency. In insolvency, the agency issue becomes acute. On the one hand, the shareholders have no incentive to invest new money to facilitate investments which may be efficient. However, debtors may not be able to attract new money invested by the new creditors, as they are afraid of most of the proceeds earned from the investment being obtained by the existing senior creditors. Therefore, insolvency law provides incentives to attract new money which allows distressed companies to be kept alive and to engage in efficient investment.

To mitigate the problems caused by some national restructuring tools, one may consider harmonization of insolvency law at the EU level. Harmonization of insolvency law may fix the drawbacks of national insolvency tools and may also make cooperation between courts easier due to the similarity of insolvency laws. Another modest solution is to tolerate the status quo and to consider the possibility of improving the group coordination proceedings under the existing provisions. The next section considers the harmonization first.

773 Distressed debtors have difficulties to raise money for further investment which could be profitable due to the large part of proceeds will be reaped by existing senior creditors. Kenneth Ayotte and David A. Skeel Jr. 'Bankruptcy Law as a Liquidity Provider' (2013) 80 U. Chi. L. Rev. 1557 p1571
5.3 Problems of harmonization of insolvency laws

5.3.1 Regulatory competition or harmonization

The regulatory competition and harmonization are different strategies to regulate one certain area of law. In the EU treaties, the word harmonization arguably means a legislative measure whereby the laws of member states can achieve the same purpose. Regulatory competition is especially a phenomenon in US company law which may either bring in best law and practice or lead to a race to the bottom. In the EU, it may not be possible for regulatory competition of insolvency law to appear at the US scale. Companies are not able to freely choose insolvency law by simply moving assets or forming subsidiaries in other member states. Also, the corporate tax directive rules out


776 The director may choose states with loose requirements on directors or transactions to incorporate so as benefit from it which incentive states to compete for the worst; the poor behaviour and notorious state company law will impact the company’s share value, which may make states to compete for the best. The hotly debate topic may not provide a clear result regarding whether regulatory competition will be overall beneficial in the US. see T. Zywicki, “Is Forum Shopping Corrupting America’s Bankruptcy Courts?” (2006) 94 Georgetown Law Journal 1141 at 1145.


the possibilities for the member states to make profits from franchise tax as Delaware does.\textsuperscript{778}

More essentially, Delaware’s experience, which is based on competitive federalism may not be necessarily the model for the future in the EU, as the EU aims to preserve the diversity of the laws of member states and discover and learn the good sides of the others.\textsuperscript{779} Competition in the EU is compatible with the goal of diversity in the sense that the knowledge and experience are mobilized and learnt by member states from the rich diversity of EU.\textsuperscript{780} Member states in the EU do not actively carry out measures to attract business, while only defensively reforming their laws to prevent their law from becoming unattractive to business. The results are positive, as shown by the law reforms such as the removal of the administrative burden and simplification of the incorporation process and reduced minimum capital requirement.\textsuperscript{781} Therefore, the concern of that competition would be a race to the bottom in the EU may overstate the danger.

As the internal market is more integrated, the strict binding measures may not be the necessary means to achieve favourable ends.\textsuperscript{782} It would be more desirable to keep the diversity of the European insolvency law so as to obtain the merits of co-evolution of member states’ insolvency law. The reason is that maintaining a certain level of diversity not only mitigates the incompatibility between existing national laws and proposed uniform insolvency law, but also encourages member states to update their out-of-date

\textsuperscript{778} Eva-Maria Kieninger, ‘The legal framework of regulatory competition based on company mobility: EU and US compared’ (2005) 6 German L.J. 741 p767
\textsuperscript{780} ibid p5
\textsuperscript{781} Wolf-George Ringe, ‘Corporate mobility in the European Union- a flash in the pan?’ (2013) University of Oslo faculty of law legal studies research paper series p31
\textsuperscript{782} Walter Van Gerven, ‘Harmonization of private law, do we need it?’ (2004) 41 Common Market L. Rev. 505 p514
insolvency laws, whereby the difficulty of cooperation resulting from varying national insolvency laws in cross-border insolvency of MCGs cases is ameliorated.  

Regulatory competition therefore is a path to search for efficient and viable law on the basis of diversity and mobilized resources. Insolvency law as part of company law engrained in unique socio-economic culture reflect one country’s political, and economic features and needs, it changes along with these factors over the time. Ingenuity of law makers of member states can be tested and spread in the context of competition, with the winning laws being accepted. 

With a mild level of competition, in the short term, member states may be able to identify the best practice developed in the EU against the guidelines, benchmark and other indicators, and adjust their suitability to the situation of each member state. In the long run, the mechanism encourages the convergence of relevant policies and laws. By contrast, the harmonized insolvency law may be improved and changed at a sluggish pace, which cannot respond to the different needs of each member state quickly. The effect of competition of insolvency law in the EU is more likely to be a race to the top.

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786 Wolf-georg Ringe, 'Forum shopping under the Insolvency Regulation' (2008) European Business organization law review p597
789 Katarzyna Gromek Broc and Rebecca Parry, Corporate rescue: An overview of recent developments from selected countries in Europe (Kluwer Law International Hague) 2004 p6
790 Ian Fletcher and Bob Wessels, Harmonisation of insolvency law in Europe (Kluwer Deventer 2012) p50
Competition may lead to forum shopping which may cause uncertainty.\textsuperscript{791} Though the benefit of forum shopping in the area of cross-border insolvency law is doubtful, it cannot be easily prevented. As long as the national insolvency laws are not the same, stakeholders of one company may seek favourable foreign insolvency law for themselves. Also, forum shopping itself reveals that certain member states' insolvency law is outdated or of low effectiveness so that they can take actions to learn from others' merits.\textsuperscript{792} One may argue that in cases where the benefits are huge as a result of forum shopping, the ineffective constraint of market forces cannot discourage debtors from forum shopping.\textsuperscript{793} Nevertheless, the new anti-forum shopping mechanisms in the EIR recast make such practice more difficult to conduct.\textsuperscript{794}

The current attitude of the EU on forum shopping seems to be only against fraudulent forum shopping.\textsuperscript{795} If creditors choose English schemes as the governing law for contracts, it implies that parties are sure that the English restructuring law may be the law to reshape the unsustainable capital structure of distressed companies.\textsuperscript{796} One thing worth mentioning is that the schemes of arrangement only deal with holding companies without non-adjusted creditors. Moreover, these creditors are generally bound by one package of agreements. Due to financial creditors' ability to adjust their interest rates, to agree ex ante regarding further movement of companies and to vote for the change of governing law of contracts, the uncertainty of forum shopping happening in this type of companies may be reduced to the lowest degree.

\textsuperscript{792}Paul Omar, ‘European insolvency laws: convergence or harmonization?’ (2012) Eurofenix Spring p22
\textsuperscript{794} See 3.2.3 Regulatory view on forum shopping
\textsuperscript{795}C-339/07 Seagon v. Dekomarty Belgium NV 2009; Jennifer Payne, Scheme of arrangement, Theory structure and operation, (Cambridge University Press 2014) p322
\textsuperscript{796}Jennifer Payne, Scheme of arrangement, Theory structure and operation, (Cambridge University Press 2014) p322
It is true that English schemes have already become a frequently used mechanism to restructure foreign distressed companies, as similar resorts cannot be found under their local laws. Member states may learn from other countries' national law and improve their own ones.

5.3.2 Problems of harmonization of insolvency law

5.3.2.1 Relationship to other laws

Insolvency law is rooted in every country's economic and social policies which may be fundamentally different; without unifying the difference of these policies, the task of harmonization of substantive insolvency laws is, if not impossible, intractable. In other words, insolvency law is a node which links many other areas of law, such as employment law and secured credit law and simply harmonizing the insolvency law in an EU wide may not be enough without touching other branches of law. Even though rescue culture is generally prevalent in the EU, member states adopt distinct approaches to try to adapt their insolvency law to the other areas of law.

Different countries still have different thoughts of design of insolvency or rescue proceedings to achieve different goals and offer varying levels of protection to certain stakeholders in an insolvency context. Also, the existing legal structure and rules may

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797 Ibid p322
800 Ibid p765
801 Ibid p765
become impediments to the new uniform insolvency law.\[^{802}\]

Since insolvency law is closely related to many other areas of law, it can only be understood with reference to other laws. The law of this kind needs explanation from the meanings of other laws, so it is not enough to harmonize insolvency law alone.\[^{803}\] Also, law manifests the social norms so that it may be difficult to absorb and understand newly created or imported concepts and regimes by the importing countries.\[^{804}\]

Harmonization of insolvency mechanisms such as refinancing rules or pre-pack sales rules may encounter the objection of local lawyers and judges, as they are reluctant to accept unfamiliar and untested concepts and doctrines.\[^{805}\] What is more, insolvency law is developed in a path dependence way; it is better to make existing law to adapt to the needs of new demands, rather than set up completely new regimes.\[^{806}\]


\[\text{\textsuperscript{804}}\text{For example, insolvency law is closely connected to corporate law. In a country which adopts manager-driven reorganization mechanisms, such as debtor in possession regime in US, it usually embraces a dispersed share ownership structure; in the countries embracing manager-displacing reorganization regimes, generally a concentrated share ownership structure will be widely adopted. The reason accounting for this phenomenon is that concentrated shareholders will have strong influence to affect decision-making of the companies at the expense of creditors, which increases the agency cost of creditors, such as monitoring cost. For this reason, to react to the concentrated shareholding, the type of debt is usually concentrated debt such as bank loans. Therefore, the banks can gain more power to obtain information and conduct monitoring accordingly, as influential shareholders may affect the manager which leads to the insolvency, the manager-displacing regime is adopted for reorganization purpose. On the aspect of diffused type of shareholding, it makes individual shareholder difficult to exploit creditors’ interests by making risky investment, so that the monitoring cost is lower than concentrated shareholding companies. As a result, companies of this type can borrow public debt for a cheaper price. As managers of the latter type may be in a relatively neutral position without influence of shareholders, it may be beneficial to keep them in the reorganization process due to their knowledge of the business. John Armour, Brian R. Cheffins, David A. Skeel, Jr. ‘Corporate Ownership Structure and the Evolution of Bankruptcy Law: Lessons from the United Kingdom’ (2002) 55 Vand. L. Rev. 1699 p1701-p1765; Katharina Pistor, ‘The Standardization of Law and Its Effect on Developing Economies’ (2002) The American Journal of Comparative Law Vol. 50, No. 1 p111-112}\]

\[\text{\textsuperscript{805}}\text{Gerard McCormack, Secured credit and the harmonisation of law, the UNCITRAL experience. (Edward Elgar Publishing Limited 2011) p49}\]

\[\text{\textsuperscript{806}}\text{The existing rules will affect the new development of rules. For example, the new development of corporate rules are built up on previous rules. See the Lucian Arye Bebchuk, Mark J. Roe, ‘A Theory of Path Dependence in Corporate Ownership and Governance’ (1999) http://papers.ssrn.com/paper.taf?abstract_id=192414 p23; see Gerard McCormack, Secured credit and the harmonisation of law, the UNCITRAL experience. (Edward Elgar Publishing Limited 2011) p49}\]

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Harmonization of insolvency law may remove obstacles of divergence of laws and it facilitates business; also it builds up neutral law which is acceptable to member states; the law may fill in the gaps of some member states if they did not have the equivalent before. However, the negotiation of the content of the harmonized law may be prolonged and costly; difficulties exist where member states may not ratify the new law.

5.3.2.2 The danger of being captured

Capture theory provides a useful tool to explain why the uniformity of insolvency law is in the danger of being captured by interest groups. The theory views regulations as the products demanded by the interest groups to act in their own interests, rather than for the public interests. Such interest groups enjoy comparable advantages so that they can influence legislation more than the public can.

The existing laws are the products of political bargaining, reflecting the advantageous interest groups’ favour. When changes of law are not in the interests of advantageous interest groups, they may object to such changes by using their power to prevent them. For example, the priority of creditors is an example that can hardly be harmonized at the EU level, as the unique ranking of priority is the manifestation of the power of each interest group. The preference of senior creditors and managers of member

states may share common ground in that they prefer their interests to be enhanced by regimes such as pre-pack administration.

Just as national legislation could be captured by interest groups, legislation process at the international level can also fall victims to interest groups’ capture.812 The redistributive nature of insolvency law creates difficulties with full harmonization of insolvency law. Such radical changes will reshuffle the balance of values that each state prioritizes. Also, full harmonization of insolvency law has the possibility of being captured by the interest groups (senior creditors and big law firms) who could influence the proposed model of the harmonized insolvency law.813

The capture activities are fuelled by self-interest of interest groups, so that they shape the legislation in their own interest, irrespective of the interest of the public.814 The political power of these interest groups is considered by the legislators, as they know that if they deliver on interest groups' demands, they have a better chance of being re-elected.815 As a result, the regulations may be demanded and shaped in favour of interest groups.816

Interest groups usually have large interests in the legislation results; they are generally small groups of people who are easily organized.817 These features not only provide them with the incentive to capture the regulation, they also make interest groups suitable exert their influence. Unlike interest groups, the vast majority of people have very weak

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812 Gerard McCormack, Secured credit and the harmonisation of law, the UNCITRAL experience. (Edward Elgar Publishing Limited 2011) p35
813 Emilie Ghio, European insolvency law: development harmonisation and reform, a case study on the European internal market’ (2015) 18 Trinity C.L. Rev. 154 p179
incentive and power to influence legislation, as each of them can only share a tiny percentage of the total benefit but incur huge costs to do so.\textsuperscript{818}

In the cross-border insolvency context, the interest groups, could for example, be banks and legal professionals. Senior creditors who hold large claims, such as banks have strong incentives and important political power to shape legislation.\textsuperscript{819} Insolvency lawyers also have very strong influence to shape the bankruptcy law legislative process, for example, with regard to the scope and substance of the bankruptcy law.\textsuperscript{820} Also it has long been recognized that professionals play important roles in insolvency law reforms.\textsuperscript{821} Certain professionals engaged in the legislative processes such as drafting the European Economic Council Bankruptcy Convention.\textsuperscript{822} Also, it is not surprising to see legal professionals become regulators or regulators become legal professionals; someone even do both at the same time.\textsuperscript{823} Regulators sometimes subordinate to the banks, as they know that they could seek bribes or long term benefit such as future job opportunities.\textsuperscript{824}

Insolvency law is an area fraught with complexity and technical mechanisms; the uniform process of insolvency restructuring law may be more likely to turn on the interests of experts and sophisticated creditors who have notable interests and knowledge.\textsuperscript{825} The capture is more likely to happen where the law contains a redistributive nature such as insolvency law and asymmetry of power between interest groups and diffused parties.\textsuperscript{826}

\begin{flushright}
\textsuperscript{818} ibid p902
\textsuperscript{819}David A. Skeel, Jr., 'Bankruptcy lawyers and the shape of American bankruptcy law' 67 Fordham L. Rev. 497 (1998-1999) p508
\textsuperscript{820} ibid (for example, the article explains that how influential the American bankruptcy lawyers are to influence legislative development and to limit other players to provide insolvency law expertise.)
\textsuperscript{824}Gerard Caprio, Jr, 'Regulatory capture: why it occurs, how to minimize it' 18 N.C. Banking Inst. 39 (2013-2014) p45
\textsuperscript{825}Edward J. Janger, Predicting when the uniform law process will fail: article 9, capture and the race to the bottom’83 Iowa L. Rev. 569 (1998) p6
\textsuperscript{826}ibid p19
\end{flushright}
compared to well organized interest groups, the public faces serious collective action problem which makes the people cannot even recognize that the harmonized insolvency law is skewed in favour of interest groups. \(^827\)

There are many NGOs and experts that have expertise and financial strength to participate in the legislative process. \(^828\) The number of these NGOs and experts are much more than before and they may be backed up by certain states or interest groups; in many cases, their voices are influential in shaping the law. \(^829\) Professionals such as judges and lawyers have large stake in the law reform and harmonization. The result of harmonization will expand the scope of professionals’ activities. The complexity of international cases will provide them with higher income and reputation and society will rely on them more than before. \(^830\)

To modernize restructuring law of EU member states, the interest groups may have incentive to favour certain type of rules which can provide them with more power and benefits. For example, they may be in favour of a group-wide pre-pack sales. In the pre-pack sale of business, involuntary creditors, such as environmental creditors, may be in danger of losing power that they could have enjoyed in ordinary business reorganization proceedings. \(^831\) Senior creditors are able to exert strong influence in a debt restructuring process and reorganization process by many methods. \(^832\) One good example is a debtor-in-possession (DIP) loan provided by the creditors to debtors. As debtors more often than not desperately need a source of financing, a DIP agreement could significantly increase

\(^{827}\) ibid p19
\(^{828}\) Gerard McCormack, *Secured credit and the harmonisation of law, the UNCITRAL experience*. (Edward Elgar Publishing Limited 2011) p8
\(^{829}\) One example could be ‘France’s observations on UNCITRAL’s working methods’ UN Doc A/CN 9/635 2007 ibid p8
\(^{831}\) Stephanie Ben-Ishai, Stephen J. Lubben, ‘Involuntary creditors and corporate bankruptcy’ (2012) 45 U.B.C. L. Rev. 253 (Providing evidence that the environmental creditors lose their power to vote against the pre-pack plan, as a result, the senior creditors and the debtors may redistribute their value to secured parties.)
creditors’ bargaining power such that senior creditors could use covenants therein to control almost everything, such as the content of the reorganization plan. DIP loans can also prevent shareholders from changing the control of the board as it will trigger the default the loans.

By the same token, senior creditors may favour the practice of using schemes and pre-pack to prevent junior creditors from competing with them for proceeds of assets. As debtors control the power of determining who should be brought into a proposed scheme, the debtors and senior creditors may use this power to leave junior creditors out of the schemes. One should note that the pre-pack sale may not necessarily increase the value of sale (in some cases, around one fifth of the value may be lost), but it may be applied as a tool to redistribute value.

The above favourable schemes with pre-pack rules can be used to achieve the cross-class cram down; the junior creditors can still be left in the worthless insolvent company while the assets are transferred to a new company formed by senior creditors. Examples can be shown in the In re Bluebrook Ltd. case and the MyTravel case.

My Travel case concerned a business transfer from insolvency debtor to new companies. Junior creditors were not offered the chance to participate in the scheme as they were

834 ibid p1240
835 Unaffected creditors may not be consulted as the proposed schemes do not try to modify their rights.
836 Jennifer Payne, Scheme of arrangement, Theory structure and operation, (Cambridge University Press 2014) p42
837 Lynn M. LoPucki, Courting failure: How Competition for Big Cases is Corrupting the Bankruptcy Courts (The University of Michigan Press 2006) p109
838 Jennifer Payne, Scheme of arrangement, Theory structure and operation, (Cambridge University Press 2014) p44-45
839 In re Bluebrook[2009] EWHC 2114 (Ch).
840 In re MyTravel Group [2004] EWHC 2741 (Ch);
unaffected by the scheme. As a result, these junior creditors were left in the worthless shell company. In the first instance, Mann J applied liquidation value as the basis to measure the value of business, since there were no alternative options for the company without schemes. As a result, the junior creditors were completely out of money. Mann J’s view may have ignored the fact that company was preparing for restructuring. A going concern valuation may therefore be more appropriate.

In re Bluebrook ltd case again involves a similar practice. The senior creditors planned to get rid of junior creditors by way of a business transfer sale. Only the senior creditors were entitled for debt to equity swap, whereas the junior creditors were not offered anything as the scheme did not seek to change their original rights. When the junior creditors went to court to reject the schemes, the court held that at the basis of going concern valuation, the junior creditors were out of money, so that their rejection was not supported.

In the Bluebrook case the court made it clear that going concern valuation should be the proper method to value companies in restructuring process. This decision tempered the inappropriateness of liquidation valuation method in the My Travel case. However, Mann J in the Bluebrook case also held that to decide whether junior creditors’ economic interests were affected, one only needs to consider whether they have interests in scheme companies; their interests are not measured against the broader backdrop of the restructuring, i.e. one needs not to calculate whether they may have interests in new

841 Ibid;
843 Jennifer Payne, Scheme of arrangement, Theory structure and operation, (Cambridge University Press 2014) p42
844 In re Bluebrook [2009] EWHC 2114 (Ch).
845 Claire Pointing, Adam Rooney, ‘IMO clears up My travel issue’ (2010) Insolvency Intelligence p50
companies to which the business of the old company was transferred.\textsuperscript{846} Therefore, junior creditors may be left in a worthless company if going concern valuation evidence shows that they are unaffected as they have no interest in the insolvent companies.

As a result, it is possible that a group-wide pre-pack may be designed as a result of the harmonization of insolvency law at the EU level, which becomes a tool for senior creditors to exploit junior creditors.

5.4 A recommendation

In this section, the thesis provides a modest recommendation which could be seen as a limit on the invocation of the opt-out mechanism in the group coordination proceedings. The recommendation is that insolvency practitioners of the financially distressed companies in the same group should have an obligation to communicate with each other and consider group rescue plan along with individual rescue plan at an early stage. This limitation on the opt-out mechanism comes from an interpretation of the Recital 5 and Article 56 of the EIR recast. Section 5.4.1 will introduce the extent and contour of this recommendation and explain why it can be achieved by interpretation. Section 5.4.2 will further enunciate reasons and benefits of this recommendation.

5.4.1 A modest recommendation for group coordination proceedings

The problem of the opt-out mechanism in group coordination proceedings is that if such opt-out mechanism can be exerted free of restraints, it is likely that local senior creditors who can control certain group member companies will refuse to consider group rescue

\textsuperscript{846} Ibid p50
plan but pursue their own interests. The consequence may be that the group going concern value will dissipate and creditors of each subsidiary will suffer a loss.

However, it appears that insolvency practitioners should not exert such opt-out power free of any constraint, as Recital 58 and Article 56 in the EIR recast together require insolvency practitioners to consider group options at an early stage. There are two important components can be drawn from Recital 58 and Article 56 of EIR recast: one is that insolvency practitioners should consider group options or communicate to the other insolvency practitioners to discuss the possibilities of group options; another is that they should do so at an early stage. As a result, insolvency practitioners of distressed companies should at least consider the possibilities of group rescue plan before opting for the individual rescue plan. The context that these two provisions operate also supports this view. The EIR recast prescribes that insolvency practitioners in each subsidiary shall exchange information and consider the possibilities of coordination plans and restructuring plans. Also, other insolvency practitioners should be informed at an early stage of the main content of coordination for the purpose of coordination proceedings. At the same time, Article 72(2) gives coordinators the power to request information from other courts and explain their group coordination plan to other courts and creditor meetings. All these provisions could be considered as limitations of opt-out mechanism as insolvency practitioners in each member company of the same group have obligation to consider the possibilities of a group plan at the time of considering the

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847 See Section 5.2.
848 Recital 58 of EIR recast 2015 provides: ‘in order to allow the insolvency practitioners involved to take an informed decision on participation in the group coordination proceedings, they should be informed at an early stage of the essential elements of the coordination.’
849 Article 56 of EIR recast 2015 says: insolvency practitioners should ‘consider whether possibilities exist for restructuring group members which are subject to insolvency proceedings and, if so, coordinate with regard to the proposal and negotiation of a coordinated restructuring plan.’
850 See EIR recast 2015 recital 58 and article 56.
851 EIR recast Article 56.
852 EIR recast Recital 56
individual rescue plan. They therefore need to communicate to and inform insolvency practitioners in other member companies regarding possibilities of group plan at an early stage.

This obligation can be drawn from a purposive interpretation of Recital 58 and Article 56 even though they are not provisions in the section of group coordination proceedings. Purposive interpretation approach is increasingly endorsed and applied by the UK courts as the primary statutory interpretation approach which aims to explain the meaning of provisions by analysing the underpinning purposes of legislators.\textsuperscript{853} This method is also dominantly employed by ECJ as a way of interpretation.\textsuperscript{854} In other words, the ECJ will take into account of the consequences of the interpretation and the purposes of one given legislation.\textsuperscript{855}

The purposes and the underlying objectives of EIR recast allow this interpretation. There are two main objectives in the EIR recast: one is to facilitate effective and efficient administration of insolvency proceedings, another is to avoid fraudulent forum shopping.\textsuperscript{856} Effective and efficient administration of insolvency proceeding requires cross-border insolvency proceedings to be able to maximise the return to creditors,\textsuperscript{857} while forum shopping prevention, among other things, can be seen as a way of creditors'

\textsuperscript{854} Nial Fennelly, 'Legal interpretation at the European court of justice' (1996) Fordham International Law Journal vol 20 (3) p656 p657
\textsuperscript{855} Giulio Itzcovich, 'The Interpretation of Community Law by the European Court of Justice' (2009) German law journal Vol. 10(05) p555
\textsuperscript{856} See Recital 3 and 5 EIR recast 2015.
protection. In the case where creditors in a given insolvent group agree to cooperate with each other, a well-functioning group coordination framework may reduce the need to conduct procedural consolidation by forum shopping, which in turn avoids the drawbacks of it. More importantly, without any constraint on the invocation of opt-out mechanism, the group going concern value may be torn apart if uncooperative controlling creditors in certain financially distressed subsidiaries refuse to support a group rescue plan without any justification. Since the goal of preservation of going concern value is the value pursued by both EIR recast and corporate rescue law, this interpretation is in line with the purposes behind the legislations. As a result, Recital58 and article 56 provide a general obligation that every insolvency practitioner should respect even without the opening of group coordination proceedings.

However, it does not mean that insolvency practitioners should always defer to the group rescue plan. The recitals of the EIR recast have made it clear that the group coordination aims to provide efficient administration for groups of companies and the opt-out mechanism aims to respect the legal personality of each entity in the same group. In other words, the EIR recast tries to strike a balance between certainty which requires the law to respect creditors' protection of each member companies and maximization of the group going concern value.

The opt-out mechanism reflects this aim, due to its voluntary nature. Creditors of one company in the group know that at the time of advancing credit, their interest will not be mixed with creditors of other group subsidiaries as group coordination proceedings.

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858 As argued in Chapter 3, procedural consolidation may not only destroy the value of the group, but also impose externality on the creditors who do not expect the whole process.  
859 Recital 54-57 of EIR recast 2015
respect each entity in the same group. On the other hand, insolvency practitioners do not need to follow the coordinator's plan as long as they have good reasons for doing it.

In terms of the option of opting out of a group rescue plan, if it can be used correctly, may reveal that the going concern value of the group is not large enough to benefit the subsidiary which chooses to opt out the plan. Also, the rejection of inclusion may reveal that the subsidiaries may be undervalued. An example would be that local creditors or other investors who have better information regarding assets of the subsidiaries, (such as its business networks with local partners, or its mandate for research and development head office function), would like to pay a high price to purchase the subsidiary. All this information may not be available to the parent company which focuses on cash management or other financial tasks.

However, the local rescue plans may not always be in the interests of all the creditors of the subsidiaries. It is in this latter case that one needs to be cautious in that the recovery rate from the local insolvency plan which is abused by the local senior creditors or investors may be lower than that of group plan, as the latter could release the group going concern value offered by the coordinator. At the same time as the certainty of the group coordination proceeding is hailed, its efficacy is doubted, especially against the background when certain creditors could exert strong control to the distressed companies. As the above sections have mentioned, since senior creditors and investors can gain control of distressed companies by refinancing contracts or loan to own debt trading, the result could render a group plan dampened due to their uncooperative and abusive strategies. Particularly, in the groups of companies context, without necessary limitations

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860 Respecting entity law is also consistent with the corporate rescue law theory discussed in Chapter 2.  
861 Article 70 in EIR recast 2015.
on the invocation of opt-out mechanism provided by the group coordination proceedings, the group plan cannot be expected to be respected by certain powerful creditors in subsidiaries even if the group plan can better serve the creditors in general. The voluntary nature of the opt-out mechanism makes subsidiaries too easy to opt-out the group rescue plan without even considering the possibility of the group rescue plan. Even in the case where the group plan has been proposed, one insolvency practitioner appointed by one subsidiary can still choose to opt out.

On the legislation level, it would be welcome if the problems of certain rules such as refinancing or pre-pack could be improved. However, to avoid the abusive usage of opt-out, these are not enough. As long as group members have different views regarding rescue, and the creditors' profiles are varying, the coordination is difficult to achieve.

To achieve the goals of preservation of group going concern value, the opt-out mechanism should not be invoked without any limitations or scrutiny. The aim is not to coerce the subsidiaries to follow the group reorganization plan. In fact, the aim is to make sure the individual plans and the group plan are both considered by insolvency practitioners so a better option can be selected. The final decision-making power is still vested in the insolvency practitioners of each company in the same group. However, insolvency practitioners of subsidiaries could make a wiser decision based on more information and have more rescue options by comparing the group plan and individual plans at early stage. Therefore, the suggested interpretation is consistent with the purposes of EIR recast and can it strikes a good balance between goal of preservation of going

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862 Under some countries 's insolvency law, courts may play a role to examine the refinancing terms such as roll-up and cross-collateralization and loan to own strategies need to be scrutinized carefully as they can be employed to redistribute assets from junior creditors to senior creditors. Legislators also put in effort in fixing the weakness of pre-pack. See US bankruptcy courts. David A. Skeel, Jr, 'The past, present and future of debtor-in-possession financing' (2003-2004) 25 Cardozo L. Rev. 1905 p1907
concern value and protection of creditors of individual company in a group. The next section will consider the main benefits of the recommendation.

5.4.2 The benefits of the recommendation

As the last section has argued, insolvency practitioners of financially distressed subsidiaries should bear an obligation to consider group rescue options at an early stage. Considering group rescue options at an early stage have three benefits.

The first benefit is that such interpretation can reduce information asymmetry so that insolvency practitioners of different companies in the same group could make better decisions regarding what to do is in the best interest of the creditors of the subsidiaries to which they are appointed. More information at least provides two merits. One is that the information relating to the insolvency or financial difficulties of some companies can be passed to other subsidiaries or parent company so that a timely group rescue plan may be considered early. Another merit is that more information can reveal the value of subsidiaries and increase the competition between group bidders and subsidiaries' bidders.

As parent companies may allocate certain head office functions to their subsidiaries, subsidiaries may have better information than parent companies in regard to how to keep subsidiaries operating in viable ways.\textsuperscript{863} It is possible that subsidiaries may have a basic understanding of the value of themselves, such as the valuable employees and relationships with key suppliers.\textsuperscript{864} Similarly, coordinators and group bidders may have better information regarding the value of the whole group. The information they possess

\textsuperscript{863} See Chapter 3 regarding the allocation of head office functions in MCGs.
\textsuperscript{864} See Chapter 2 regarding 'group going concern value.'
may allow them to value the subsidiaries against the backdrop of the group going concern value.

The communication of all relevant information between insolvency practitioners of subsidiaries and insolvency practitioners who propose group coordination proceedings is desirable. The information of insolvency practitioners who aim to open a group proceeding may provide clues regarding whether the group going concern value exists and whether it is large enough to cover the cost of coordination. Insolvency practitioners have options including joining in a group plan to benefit from the group going concern value or taking an individual rescue plan to avoid an implausibly costly group plan. Therefore, insolvency practitioners have to compare and assess whether the group plan is a better option to the company in which they are appointed.

The group plan may benefit creditors in the subsidiaries by preservation of group going concern value. If the going concern value is large, the group plan may offer a higher price for the subsidiary than the price of a local reorganization plan. By competition, which offer is better becomes clear. Where the benefit of a group plan is obvious, local senior creditors’ opt-out is difficult to be justified and supported.

Where the deal requires courts’ approval, courts should not approve the individual plan if evidence clearly shows that the group plan will offer the creditors in general of those subsidiaries a better recovery. The local senior creditors may not hold out by providing evidence of a much higher than reasonable value of one subsidiary. Assuming the group bidders give up purchasing the subsidiary, the higher price that the local senior creditors
have claimed from group bidders will make more junior creditors become in the money creditors who will share with those hold-out senior creditors.

By considering the group plan, information can be shared with other insolvency practitioners or debtor in possession, and more potential bidders may be identified. This to some extent rectifies the transparency problems of pre-pack as debtors may only disclose information to cherry-picked stakeholders while leaving other creditors with nothing.\textsuperscript{865} Considering the group option via communication encourages more information to be exchanged so that the relevant parties and courts can make better options based on more information. Also, it reduces the level of local creditors’ control as other insolvency practitioners may provide better offers and challenge the local rescue plan. This in turn provides directors and other stakeholders confidence to enter into insolvency proceedings.\textsuperscript{866} More plans and discussions based on the information so disclosed would make the reorganization more transparent.\textsuperscript{867} The opinions of representatives of other junior creditors are also critical for the debtors and courts to make sound judgments regarding the option of rescue plans and valuation of the business.\textsuperscript{868} Coordinators could be seen as neutral parties\textsuperscript{869} who facilitate the group option and monitor the undesirable individual rescue options.

The second benefit is that an early consideration of group rescue option can reduce the strategic opportunism exerted especially by local bidders. As information asymmetry may

\textsuperscript{866}Harvey R. Miller, ‘Chapter 11 in Transition -From Boom to Bust and Into the Future’ (2007) 81 Am. Bankr. L.J. 375 p384
\textsuperscript{867}Michelle M Harner and Jamie Marinicic, ‘Behind Closed Doors: The Influence of Creditors in Business Reorganizations’ (2010-2011) 34 Seattle U. L. Rev. 1155 p1181
\textsuperscript{868}ibid p1182
\textsuperscript{869}Similar to ABI commission’s idea to appoint a neutral party for the pre-pack deals to monitor the process. see ABI Commission to study the reform of Chapter 11 2014 p6
be abused by either group bidders or local senior creditors to gain benefit for themselves, 
this obligation allows creditors or insolvency practitioners to make better decisions. 
Group bidders may consider the value of a whole group on the basis of a group going 
concern valuation. The price that the group bidders would like to pay may be higher than 
the local bidders. Similarly, it is possible that local senior creditors have access to locally 
available information which may indicate that the value of a subsidiary is even larger than 
the group bidders expected. For the purpose of protection of local interests, the insolvency 
practitioners or local senior creditors may persuade group bidders to increase the value. If 
such locally available information is disclosed, it is possible that the group bidders accept 
a higher price. Even though the group bidders may still reject the suggested price of a 
local price, this price may be used as a reference price which prevents local senior 
creditors from deliberately selling the subsidiary at a much lower price in a future pre- 
pack sale in an individual rescue plan.

Local senior creditors or investors who decide to opt-out of the group coordination 
proceedings may have the incentive to block the flow of information relevant to the true 
value of the subsidiaries against local junior creditors and other stakeholders. When the 
negotiation comes to the table of general local creditors, local senior creditors may have 
an incentive to undervalue the subsidiaries so as to extract value, such as what may 
happen in a pre-pack. By contrast, when the deal happens between local senior creditors 
and group bidders, local senior creditors or investors may overestimate the value of 
subsidiaries with the aim of striking a better deal with the bidders who wish to purchase 
the whole group.
The difference of the two prices may be remarkable, since the local senior creditors may only have incentive to benefit themselves either by extracting value from others or by hold-out. A possible solution is to facilitate the exchange of information and the communication between relevant group companies so that the true value of an individual subsidiary and the value of the group could be revealed.

Therefore, local insolvency practitioners' information may be used to prevent one individual subsidiary from being undervalued by the potential bidders for the whole group. Also, information of coordinators or group bidders can prevent local senior creditors from deliberately selling the subsidiaries that they have controlled at undervalue prices. No matter whether they decide to join or refuse the group plan, they should consider it when they consider the individual reorganization plans. After a holistic consideration, they may decide to turn down the group plan or individual plan based on a scrupulous judgement.

The third benefit of considering group rescue option at an early stage is the requirement of corporate rescue practice, especially the pre-pack sale practice. When the group rescue plan are considered too late, many important stakeholders such as suppliers of subsidiaries and important employees may flee away.870 Also, due to the knock-on effect or cross-default covenants, one subsidiary's default may cause the default of other group companies. As a result, insolvency practitioners may quick lose the control of the companies in the group whereas the senior creditors may gain leverage quickly and pursue their interests at the expense of other creditors.871

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871 Chris Howard and Bob Hedge, Restructuring law and practice (Second edition LNUK 2014) Chapter 2 p33-52
Also, it can prevent a fire sale conducted by pre-pack practice which only benefit senior creditors. In many cases, the parent companies would be the first to know the financial difficulties of the group compared to the operating subsidiaries. As parent companies are generally the companies that arrange financing on behalf of the group, they may possess the best financial information of the group. In these cases, the group coordination proceedings may be opened at the court where the parent companies are based. For each subsidiary, the task of the insolvency practitioners is to consider whether the group option offers subsidiaries a better option. It is also possible that the debts of the group are not arranged at the holding companies level so that the parent company has no informational advantages. Therefore the individual rescue option may be negotiated prior to the group rescue option.

Taking a pre-pack sale case as an example, the creditors of subsidiaries may choose to execute a fast sale of the subsidiaries without considering the group plan. The pre-pack is notorious for a lack of transparency, creditors' protection\footnote{Especially in the UK, the pre-pack sale could be done without creditors' and courts' approval. Netherlands and the US requires the court approval, however, the abuses in pre-pack cases still exist. Ramon Smits, 'Supervision and efficiency of the pre-pack: An Anglo-Dutch comparison' (2016) International corporate rescue 13(1) p35} and limited marketing.\footnote{Tom Astle, 'Pack up your troubles: addressing the negative image of pre-packs' (2015) Insolvency Intelligence p1-2} At the time of organising a pre-pack sale for a subsidiary, the insolvency practitioners of other group member companies may not know about it. When the plan has been drafted, the administrator can execute it immediately after he is appointed out of court. This leaves other parties with no time to challenge it or offers a group rescue solution.

Such interpretation corresponds to national insolvency law as well. Taking the UK as an example, the third version of the statement of insolvency practice 16\footnote{Statement of practice 16 issued on 01 November 2015 by R3: Association of Business Recovery Professionals} requires the administrator to decide whether it is appropriate to conduct a pre-pack sale for the
Administrators not only need to carry out broad marketing for the sale of the business, but also need to disclose information to the creditors to the extent that informed creditors could judge whether the pre-pack is a good solution to the company. One may therefore argue that without considering the group plan, it is difficult for the administrator of one subsidiary to make the final judgment that saving the subsidiary individually is best in the interest of all the creditors of that subsidiary. The administrators may skip broad marketing which may solicit purchasers who would like to pay a price reflecting the group going concern value. The consequence is that the creditors of that subsidiary do not receive the possible surplus from the group going concern value.

With such interpretation in mind, certain abuses of the opt-out mechanism may be mitigated. Taking the pre-pack of one subsidiary as an example, in a typical UK pre-pack case, the insolvency plan is generally negotiated between certain senior creditors and debtors before the appointment of an administrator. Immediately or shortly after the appointment of the administrator, the administrator is able to sell the assets of the debtor to the purchaser before the creditors meeting. Assume that such a pre-pack sale plan is negotiated by the senior creditors and directors with the involvement of the would-be administrators. As the administrators have to execute the deal later, they need to provide enough evidence to explain why the pre-pack plan of the subsidiary is the best solution. If they have an obligation to communicate the information to other insolvency practitioners or debtor-in-possession, and to consider a group restructuring plan at an earlier stage under the EIR recast, their report is not convincing without even considering group rescue plans.

875 ibid p2
876 ibid p2, p4
The doubts of such a deal from other parties and courts may rise, especially where the law allows insolvency practitioners to conduct a sale of the whole business without the approval of creditors and courts as it is in the UK. Together with the fact that administrators could be appointed out of court by holders of floating charge or directors, all these procedures and negotiations may be done in bad faith and in fleeting time. What the rest of the creditors have to face is a *fait accompli* conclusion that the sale is in the interests of creditors in general. As a result, administrators may be responsible for the abuse.

In some countries such as Netherlands and the US, a pre-pack deal needs courts' approval. The courts may be good at examining the abuse of law, hence this design of pre-pack may to some extent prevent certain abusive uncooperative strategies from the subsidiaries. Also, the direction of the US pre-pack regulation seems to be towards a focus on enhanced protection to creditors in general. However, whether the sale is the best solution is a commercial judgment, so that the supervisory role of the courts are limited. More importantly, the courts are not the first to hear about the pre-pack deal; replying on court examination will not provide other insolvency practitioners enough time

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879 When considering whether to approve the sale, the court may consider whether the sale is a de facto reorganization plan while disenfranchising creditor’s protection endowed by the confirmation of chapter 11 plan. The alertness of the US courts highlight that the removal of the creditors’ protection is the quid pro qua of fast speed of pre-pack, which may give rise to abuse by senior creditors. Craig A. Sloane, ‘The sub rosa plan of reorganization: side-stepping creditor protections in chapter 11’ (1999-2000) 16 Bankr. Dev. J. 37 p61
880 The court scrutiny could be seen as a form of creditors’ protection, as otherwise the creditors’ interest may suffer due to unable to join in the coordination proceedings, also it could be viewed as a solution to the anti-commons issue as otherwise the subsidiaries may strategically choose to hold-out by opting out of the group coordination proceeding as long as it could receive an not proportionate payment from other member companies.
881 The US commission to study the chapter 11 is of the opinion that since sale of the whole business is essentially affect all the stakeholders’ interests, the creditors’ protection should not be weaker than the general reorganization procedure. Rolef J. de Weijis and Bob Wessels, ‘Proposed Recommendations for the Reform of Chapter 11 U.S. Bankruptcy Code’, Amsterdam Law School Legal Studies Research Paper No. 2015 (2014) p11
882 For example, the UK courts are more inclined to reply on insolvency practitioners’ views. See Bolanle Adebola, ‘Proposed feasibility oversight for pre-pack administration in England and Wales: window dressing or effective reform?’ (2015) Journal of Business Law p3
to prepare the possibilities of an alternative group reorganization plan. A desirable solution in the cross-border insolvency of groups of companies context is to encourage parties to consider the group reorganization plan and the individual group member plan at an earlier stage.

After considering all three benefits that the recommendation could bring, one should notice that the cost of exchange of information throughout a group rescue plan may not be ignored. The recommendation does not suggest that every subsidiary should consider its own version of group plan. Rather, the key is to exchange information so that the question whether a group rescue plan is desirable can be answered at an early stage. Also, the cost as such does not derive from the recommendation itself; it is a general drawback of procedural cooperation solutions where the cooperation between different parties itself will give rise to costs. Nonetheless, it is a workable framework in that it provides certainty to creditors of different subsidiaries in different jurisdictions.

To sum up, the insolvency practitioners of member companies should consider group rescue options at the time of considering individual rescue options at an early stage. They should do so by disclosing information to other insolvency practitioners in the same group when an individual rescue plan is negotiating; they should also discuss the possibility of group rescue plans. By considering group rescue plans at an early stage, more information and options are available for the relevant parties and insolvency practitioners. It is easier for them to decide which options may better serve the creditors in general of one member company. As a result, the ability of group coordination proceedings to preserve group going concern value is improved.
Chapter 6 Conclusion

This thesis examines solutions for cross-border insolvency of MCGs in the EU. Since many businesses are in the form of multinational companies, the cross-border insolvency issues of groups of companies have quickly attracted the attention of academics and practitioners. It is generally believed that solutions which could centralize the insolvency proceedings of MCGs will generate a favourable result to creditors in general. The reason is that there may be certain value between the member companies of groups. One important omission of the literature is that the relevant research is done without linking to the theories of multinational enterprises. A good understanding of the theories of corporate rescue law can indicate what goals that corporate rescue law aims to pursue; a good understanding of relevant multinational enterprise theories can reveal the characteristics of multinational enterprises so one can understand how to achieve these goals in the context of cross-border insolvency of groups of companies.

The originality of this thesis is that it examines MCGs through a new perspective: a business network perspective in a combination of corporate rescue law theories and multinational enterprise theories.

The thesis started by analyzing theories of corporate rescue law. The rationale of corporate rescue law is to preserve the going concern value. Going concern value is a concept as opposed to liquidation value realized in cases where the distressed companies are sold in a piecemeal way.\textsuperscript{883} The surplus that going concern value contains indicates that the distressed companies or business can use the resources they possess in an efficient way. Therefore, it is desirable to preserve this surplus by keep the distressed companies or business intact. Equally important is the requirement of certainty, as insolvency law has

an impact on the interest rate. It concludes that preservation of going concern value and certainty are the main values which corporate rescue law aims to achieve.

By examining the MCGs, the main argument of this thesis is that MCGs may have group going concern value in the relationships of member companies. The relationships among subsidiaries form 'pipes' for resources and knowledge to transfer to each other. Corporate rescue law and cross-border insolvency law theories aim to achieve the goal of preserving going concern value. In the cross-border insolvency of MCGs context, such a network itself can be seen as part of the group going concern value which should be preserved. Therefore, it is desirable to have a general cross-border insolvency framework to preserve such value.

For the purpose of gaining group going concern value, the parent companies in the group should allocate head office functions to subsidiaries. This finding has implication for the insolvency jurisdiction rule which is based on the location where the head office functions are carried out. The head office functions of a MCGs may be spread across subsidiaries in different countries and ascertainable to creditors, it is difficult to create a group CoMI by which all the foreign subsidiaries are controlled. As a result, the insolvency jurisdiction of each subsidiary should be respected.

On the basis of the above theories and analysis, the thesis examined the main existing solutions for cross-border insolvency of MCGs. There is no one-size-fits-all solution for cross-border insolvency of groups of companies due to the varying characteristics of different cases.

This thesis has examined three main solutions for cross-border insolvency of MCGs: procedural consolidation by jurisdiction rules; market/hybrid legal solutions by
renegotiation of contracts or transfer of business; procedural cooperation by a cooperative legal framework under EIR recast.

Procedural consolidation has attracted much attention in recent years. Many scholars believe that procedural consolidation, by allocating insolvency jurisdiction to one court, could accomplish the goal of preservation of group going concern value. However, the uncertainty resulting from the procedural consolidation cannot be ignored.

The thesis challenged the attitude towards procedural consolidation with reference to the conclusion of the analysis of multinational enterprise theories. From a business network perspective of MCGs, it indicated that head office functions of MCGs are neither always centralized in a parent company, nor neatly allocated to certain subsidiaries. The concept of the group CoMI is difficult to determine in reality. Therefore, cross-border insolvency theories relying on group CoMI as jurisdiction rules may not be reliable. That is not to say that procedural consolidation should be completely denied. In cases where evidence clearly shows that the CoMIs of all subsidiaries are in the jurisdiction of the parent company, procedural consolidation is still a possible option. The point made here is that such cases in reality may not be easy to find.

The thesis is also aware of the market/hybrid legal solutions in practice. These solutions have merits to avoid group-wide insolvency or to sell the group as a going concern by encouraging renegotiation of debt contracts with the help of legal tools such as cram-down in some cases. These solutions may preserve the group going concern value and provide certainty, especially where financial creditors are collectively subject to concentrated loan agreements. However, the thesis also identified the limitations of informal/hybrid legal solutions. Given the limitations of procedural consolidation and market/hybrid legal solutions, it argued that it is desirable to have a general cooperation
and coordination legal framework to fill in the gap for cross-border insolvency of MCGs.

The New EU regulation group coordination proceeding is such a general framework for the groups of companies in the EU. It is generally believed that the opt-out mechanism of group coordination proceedings will significantly reduce its utility in practice. This thesis contributes to the existing literature by analyzing the opt-out mechanism in the light of above theories and senior creditors control literature. It points out that the opt-out mechanism may take issue with the goal of preservation of group going concern value. The opt-out mechanism allows local senior creditors or investors of subsidiaries to enrich themselves at the expense of local creditors and group creditors. This may happen when senior creditors have exerted control by refinancing tools or by exerting loan-to-own strategies in the debt market. Local senior creditors may either conduct a fire sale of subsidiaries or hold-out with the hope of extracting value from creditors of other subsidiaries or group bidders. The thesis is aware of the call for harmonization of insolvency law. Though harmonization of insolvency law may help correct certain drawbacks of national law and facilitate cooperation, it is a radical solution facing significant difficulties.

To address this issue, this thesis provides a modest recommendation. It argues that the invocation of the opt-out mechanism is not without limitation. In EIR recast, insolvency practitioners are obliged to exchange information and propose group rescue plans at an early stage. This requirement constrains local senior creditors to completely ignoring the group option. Subsidiaries should consider a group rescue option and individual option together and choose the one which may provide better results. The exchange of information provides benefit to mitigate certain abusive strategies.

The limitation of this solution is that the cost of cooperation may be notable. However,
this is largely due to the cooperative nature of the legal framework whereby every subsidiary's interest should be respected. Future research may focus on the clarification of conditions regarding invocation of opt-out mechanisms in cross-border insolvency of MCGs context, so that more certainty can be obtained.
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