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Reconsidering procedural consolidation for multinational corporate groups in the context of the recast European insolvency regulation

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## **Abstract**

Procedural consolidation aims to provide a solution for multinational corporate groups to achieve the goals of preservation group value and certainty. This article explores the desirability of procedural consolidation in the light of multinational enterprises theories, in particular, through the lens of business network perspective. It argues that there is an inherent difficulty to balance the goal of preservation of group value and the goal of certainty by procedural consolidation. This is due to the fact that multinational corporate groups achieve an important part of group value by means of spreading head office functions across the group; pulling subsidiaries into one insolvency jurisdiction will either destroy such value or disrespect the current insolvency jurisdiction rule.

## **1. Introduction**

When some subsidiaries in one multinational corporate group (Hereafter MCGs) face financial difficulties, the other subsidiaries in other member states will also suffer.<sup>1</sup> Procedural consolidation is a way to facilitate the insolvency of MCGs by allowing the insolvency proceedings of foreign companies in the same groups to open in one national court. The rationale underpinning procedural consolidation is to preserve the value of corporate groups as one economic integration and reduce the cost of

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<sup>1</sup>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

multiple insolvency proceedings that would otherwise incur. Also, both corporate rescue law theory and cross-border insolvency law theories embrace the value of certainty. Procedural consolidation therefore needs to provide a good balance of these values.

To make procedural consolidation happen, there are two possible ways. One radical way is by free choice of insolvency law, which is almost impossible due to its serious drawbacks. Another conduit is by means of insolvency jurisdiction rules; it entails one court having insolvency jurisdiction for all group members. The latter touches on the insolvency jurisdictional rule-Center of main interest (CoMI) in the EU regulation on insolvency proceeding recast 2015(EIR recast).<sup>2</sup>A prerequisite basis for procedural consolidation is to find group CoMI or move CoMI of subsidiaries to one place.

The aim of this article is to examine whether procedural consolidation is a reliable solution for large MCGs in the EU. It explores this issue in the light of multinational enterprise theories especially via a business network perspective. It argues that there is an inherent difficulty for procedural consolidation to achieve preservation of group value and certainty at the same time, as one main part of MCGs' value is obtained by allocating head office functions to subsidiaries. The conclusion is that procedural consolidation may only be applied in very limited cases and it is not a reliable solution for MCGs.

## **2. The theoretical underpinning of procedural consolidation**

Procedural consolidation means that subsidiaries belonging to the same insolvent MCGs can open their insolvency proceedings in ideally just one court.<sup>3</sup>Arguably, the benefit of

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<sup>2</sup> Regulation (EU) 2015/848 of the European Parliament and the Council of 20 May 2015 on insolvency proceedings (recast)

<sup>3</sup> Irit Mevorach, 'Appropriate Treatment of Corporate Groups in Insolvency: A Universal View', (2007) European Business Organization Law Review 8 p189

it is to preserve the group value and to avoid additional cost arising from multiple insolvency proceedings which are otherwise opened. As a solution for the cross-border insolvency of MCGs aiming to preserve group value, one can argue that procedural consolidation can trace its purposes from both cross-border insolvency law and corporate rescue law: maximization of value and certainty.

The corporate rescue law is built around a concept named going concern value.<sup>4</sup>It is generally believed that going concern value may exist only when a company is kept intact and running.<sup>5</sup> In other words, an operating company may worth more intact than if it is broken up.<sup>6</sup>Therefore, releasing going concern value is in the interests of all the creditors and stakeholders.<sup>7</sup>Also, it is believed 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 the cost of insolvency<sup>8</sup>and the high cost of borrowing interest rate.<sup>9</sup>This is the certainty requirement pursued by corporate rescue law.

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<sup>4</sup>Going-concern value is the value of a company as an ongoing entity. This value differs from the whole 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](http://www.investopedia.com/terms/g/going_concern_value.asp)

<sup>5</sup> Douglas G. Baird, 'Bankruptcy's Uncontested Axioms' (1998-1999)108 Yale L.J. 573 p577

<sup>6</sup> Douglas G Baird and Robert K Rasmussen, 'the end of bankruptcy' (2002) 55 Stan L rev 751 p758

<sup>7</sup>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

<sup>8</sup> Thomas H. Jackson, *The logic and limits of bankruptcy law* (Harvard university press 1986) p21; Douglas G. Baird, 'Loss Distribution, Forum Shopping, and Bankruptcy: A Reply to Warren' (1987)54 U. Chi. L. Rev. 815 p825

<sup>9</sup> See general Alan Schwartz, 'A Normative Theory of Business Bankruptcy' (2005) Faculty Scholarship Series. Paper 303; Yaad Rotem, 'Pursuing Preservation of Pre-Bankruptcy Entitlements: Corporate Bankruptcy Law's Self-Executing Mechanisms' (2008) 5 Berkeley Bus. L.J. 79

Cross-border insolvency law theory territorialism<sup>10</sup>and universalism<sup>11</sup>also acknowledge the goals of value maximization and certainty. The two main cross-border insolvency theories hold different views on the means of allocation insolvency jurisdiction.

Territorialism argues that international insolvency cases should be regulated by courts whichever possess the assets of the debtors. The consequence is that more than one court is entitled to open insolvency proceedings, due to scattered assets in various countries. Universalism argues that ideally, there should be one court and one set of insolvency law to be applied to one cross-border insolvency case. It is generally believed that universalism has advantages over territorialism due to it can serve the goals of value maximization and certainty of rules better. Since one multinational company technically may have assets in every country in the EU, the multiple insolvency proceedings may stymie the possibility of rescue plans. Also, creditors incur more costs to monitor the movement of assets, as it is easier to transfer assets abroad

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<sup>10</sup>Lynn LoPucki, 'Cooperation in international bankruptcy: a post universalist approach'(1998-1999) 84 Cornell L. Rev. 696; Lynn LoPucki, 'The case for cooperative territoriality in international bankruptcy' (1999-2000) 98 Mich. L. Rev. 2216; Frederick Tung, 'Is international bankruptcy possible?' (2001-2002) 23 Mich. J. Int'l L. 31; Lynn LoPucki, 'Universalism unravels'(2005) 79 Am. Bankr.L.J.143; Lynn LoPucki, 'Global and out of control' (2005) 79 Am. Bankr. L.J. 79

<sup>11</sup> Nigel John Howcroft, 'Universal versus territorial models for cross border insolvency: the theory, the practice and the reality that universalism prevails' (2007-2008) 8 U.C. Davis Bus. L.J. 366; Jay Westbrook, 'Priority conflicts as a barrier to cooperation in multinational insolvencies.'(2008-2009) 27 Penn St. Int'l L. Rev. 869; Jay Westbrook, 'Multinational enterprises in general default: chapter 15, the ALI principles, and the EU insolvency regulation'(2002) 76 Am. Bankr. L.J. 1; Jay Westbrook, 'Locating the eye of the financial storm'<sup>32</sup> Brook. J. Int'l L. 1019; Jay Westbrook, 'Breaking away, local priorities and global assets'(2006-2007) 46 Tex. Int'l L. J. 601; Jay Westbrook, 'A global solution to multinational default' (1999-2000) 98 Mich. L. Rev. 2276

than the whole company. The predictability of insolvency jurisdiction rules is required by cross-border debt transactions.<sup>12</sup>

As above mentioned, universalism allocates insolvency jurisdiction by the unit of a company rather than an asset. It has gained support widely in the world and its modified version has been adopted by EIR recast 2015 with some compromises.<sup>13</sup>In this regulation, the insolvency jurisdiction of one company is allocated to the court possessing the CoMI of that company. CoMI is presumed to be the registered place of the company, while ultimately it should correspond to the place where the company conduct its non-transient main business and ascertainable to third parties.<sup>14</sup>

A series of cases shape the development of the concept of CoMI.<sup>15</sup>It is generally believed that CoMI is the place where the head office functions of one company are carried out; <sup>16</sup>all factors need to be considered when determining CoMI; these factors have to be available in public domain and ascertainable to creditors.<sup>17</sup>Also, the mainstream consensus is that every company's CoMI has to be determined in an entity-by-entity manner.<sup>18</sup>Furthermore, that a parent company simply being able to exert control over subsidiaries is not adequate to conclude that the subsidiaries' CoMI is in the

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<sup>12</sup> Samuel L. Bufford. 'Center of main interests, international insolvency case venue, and equality of arms: the Eurofood decision of the European court of justice.' (2006-2007) 27 Nw. J. Int'l L. & Bus. 351 p381

<sup>13</sup> EIR recast 2015

<sup>14</sup> Virgós-Schmit report at para 75; see EIR recast Article 3 (1)

<sup>15</sup>In re Eurofood IFSC Ltd [2006] Ch. 508; Re Stanford [2010] EWCA Civ 137; Interedil case [2012] B.C.C. 851

<sup>16</sup> Luci Mitchell-Fry, Sarah Lawson, 'Defining CoMI, where are we now.' (2012) Corporate Rescue and Insolvency, p16

<sup>17</sup>In re Stanford International Bank Ltd and another[2010] Bus. L.R. 1270 p21

<sup>18</sup> In re Eurofood IFSC Ltd [2006] Ch. 508 para116

place where the parent's CoMI is located.<sup>19</sup>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.<sup>20</sup>

Theoretically, procedural consolidation of the insolvency of MCGs needs to base on CoMI rule. However, it can be argued that private parties may decide insolvency jurisdiction autonomously by agreeing on an insolvency jurisdiction for the whole MCGs. The next section will consider its practicability.

### **3. Procedural consolidation by free choice of insolvency law**

Theoretically, procedural consolidation can be achieved by allowing parties to free-choice insolvency jurisdiction or CoMI. This section only concerns the former situation.

Free choice insolvency law provides that members of companies make the choice at the time of incorporation, and the choice could be changed later with creditors' consent.<sup>21</sup>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. In terms of

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<sup>19</sup> In re Eurofood IFSC Ltd [2006] Ch. 508 para112

<sup>20</sup>Federico M. Mucciarelli, 'Private international law rules in the Insolvency Regulation Recast: a reform or a restatement of the status quo?' (2015) available at: <http://ssrn.com/abstract=2650414> p11

<sup>21</sup> Robert K Rasmussen. 'A new approach to transnational insolvency' (1997-1998)19 Mich. J. Int'l L. 1 p5

free-choice of insolvency law, there are constraints on the application of procedural consolidation: collective nature of insolvency law and differing member states' insolvency law.

Free choice of insolvency law will interrupt the collective nature of insolvency law. The insolvency of one debtor influences all its creditors together, so insolvency law aims to provide a collective solution to all the affected parties.<sup>22</sup> This is partly because non-insolvency law does not prescribe how to resolve collective issues faced by insolvency law, issues regarding how to protect different stakeholders and how to distribute assets are of a collective nature which cannot be answered by non-insolvency law.<sup>23</sup> Also, without collective solutions, 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.<sup>24</sup> The collective nature means that it is desirable to apply one country's insolvency law as an integration rather than sourcing insolvency provisions from different countries.

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<sup>22</sup> In general see Ian Fletcher, *The law of insolvency*, (4th Edition Sweet & Maxwell London 2009)

<sup>23</sup> Douglas G. Baird '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.p103; Nicholas L. Georgakopoulos, 'Bankruptcy law for productivity' (2002) 37 *Wake Forest L. Rev.* 51 p92

<sup>24</sup> 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 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.



Another point worth mentioning is that corporate rescue law is in reality complex and elastic.<sup>25</sup> Whereas German insolvency law may focus more on debt collection, French insolvency law focuses more on social goals such as employment protection.<sup>26</sup> The same creditors in different member states may be treated differently. 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.

Imagining 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 the choice of law rules. Where one court is entitled to seize jurisdiction, it could apply its own insolvency law to the given case.

EIR recast reflects this idea by incorporating a set of harmonized insolvency choice of

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<sup>25</sup> Elizabeth Warren 'Bankruptcy Policy' (1987) 54 U. Chi. L. Rev. 775 p777, p811

<sup>26</sup> Horst Eidenmüller, 'Comparative Corporate Insolvency Law' (2016) European Corporate Governance Institute (ECGI) - Law Working Paper No. 319 p10

law rules.<sup>27</sup>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.<sup>28</sup>To protect the local interests, the regulation also provides certain exceptions to *lexi fori concursus*.<sup>29</sup>As a result, when procedural consolidation is considered by pulling other insolvent subsidiaries in front of the court of another jurisdiction, the consequence may be that certain creditors' rights are modified unfairly and unpredictably.

Also one cannot ignore the interaction of insolvency law and other laws in one country. Insolvency law closely connects to employment law, corporate governance and secured credit law.<sup>30</sup>Allowing parties to opt for another country's insolvency before insolvency proceeding will break such interaction; also, parties may not be familiar with the chosen foreign law.<sup>31</sup>

A reason based on impracticability to refuse procedural consolidation is that procedural consolidation also requires all the countries to accept free choice of insolvency law regimes. Currently, no countries allow participants to decide jurisdiction and choice of law beforehand even if negatively affected creditors are compensated; 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

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<sup>27</sup>EIR recast Article 7 See comments on previous EIR HICOL in general: Bob Wessels, *International insolvency law*, (Kluwer The Netherlands 2006)

<sup>28</sup>EIR recast Article 7(2)

<sup>29</sup>EIR recast Article 8-article 18

<sup>30</sup>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' (2002) 55 Vand. L. Rev. 1699 p1701

<sup>31</sup>Gerard McCormack, *Secured credit and the harmonisation of law, the UNCITRAL experience*. (Edward Elgar Publishing Limited 2011) p49

make a local court give up jurisdiction.<sup>32</sup>Further, 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. Also, the complexity and inflexibility make companies costly and difficult to change chosen insolvency law.<sup>33</sup>

Another drawback is that influential creditors may choose insolvency law that benefits 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.<sup>34</sup>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.<sup>35</sup>The number and size of non-adjusting creditors' claims may not be ignorable.<sup>36</sup>Unsecured claims pervasively exist in most of the cases and account for a considerable portion of unsecured claims.<sup>37</sup>

One may argue that a consensus regarding which insolvency law will be chosen may be difficult to achieve due to the number of creditors involved; the multiple bankruptcy law options give rise to transaction costs to negotiate an agreement.<sup>38</sup>The cost to conclude

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<sup>32</sup>John A. E. Pottow, 'A New Role for Secondary Proceedings in International Bankruptcies' (2010-2011) 46 *Tex. Int'l L. J.* 579 p588

<sup>33</sup>Gerard McCormack 'Jurisdictional competition and forum shopping in insolvency proceedings' (2009) *The Cambridge Law Journal*, 68 p178

<sup>34</sup>Jay Lawrence Westbrook, 'A global solution to multinational default' (1999-2000) 98 *Mich. L. Rev.* 2276 p2305

<sup>35</sup>Lynn. Lopucki, 'The case for cooperative territoriality in international bankruptcy' (1999-2000) 98 *Mich. L. Rev.* 2216 p2247

<sup>36</sup>Robert K. Rasmussen, 'Resolving transnational insolvency through private ordering' (1999-2000) 98 *Mich. L. Rev.* 2252 p2273

<sup>37</sup>Elizabeth Warren and Jay Westbrook, 'Contracting out of bankruptcy: an empirical intervention' (2004-2005) 118 *Harv. L. Rev.* 1197 p1245

<sup>38</sup> *ibid* p1249

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.<sup>39</sup> 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 be subject.<sup>40</sup> 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. Therefore, procedural consolidation may more practicably be achieved by means of CoMI.

#### **4. The puzzle of group CoMI**

Since the last section reveals the drawbacks of procedural consolidation achieved by free choice of insolvency law, this section deals with the question whether procedural consolidation can rely on the basis of CoMI.

It is obvious that EIR recast does not provide the concept of group CoMI. The benefit of centralizing insolvency proceedings of group members into one jurisdiction (in most cases, the parent's jurisdiction) have long been recognized.<sup>41</sup> This requires one to find a joint group CoMI so that one court could deal with the cross-border insolvency for an entire group. 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.<sup>42</sup> It is

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<sup>39</sup>Lynn Lopucki 'Cooperation in international bankruptcy: a post-universalist approach' (1998-1999) 84 Cornell L. Rev. 696 p739

<sup>40</sup>Jay Lawrence Westbrook, 'A global solution to multinational default' (1999-2000) 98 Mich. L. Rev. 2276 p2306

<sup>41</sup>Samuel L. Bufford, 'Coordination of Insolvency Cases for International Enterprise Groups: A Proposal' (2012) 86 Am. Bankr. L.J. 685 p711

<sup>42</sup>Irit Mevorach, 'The "home country" of a multinational enterprise group facing insolvency' (2008) International & Comparative Law Quarterly, p8

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.<sup>43</sup> Under this situation, one court can administer the group insolvency without the need to design new provisions specific for group insolvency.<sup>44</sup>

This thread of suggestions in regard to procedural consolidation is mainly built on the existing CoMI concept.<sup>45</sup> It is one thing to recognise the seeming desirability of procedural consolidation based on group CoMI; it is another thing to determine under what circumstances can one say with confidence that one given group can be procedurally consolidated. The business-integrated and control-centralized corporate groups may be difficult to define 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, it is far-fetched to argue there is a joint group CoMI. The next section will consider whether group CoMI

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<sup>43</sup>Gabriel Moss, Christoph G. Paulus, 'The European Insolvency Regulation - the case for urgent reform' (2006) *Insolvency Intelligence* p5

<sup>44</sup>*ibid* p5

<sup>45</sup> See Irit Mevorach, 'The "home country" of a multinational enterprise group facing insolvency' (2008) *International & Comparative Law Quarterly*, p8 (says that 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.) Ralph R. Mabey Susan Power Johnston, 'Coordination among insolvency courts in the rescue of multinational enterprises' (2008) 34th Lawrence P. King & Charles Seligson Workshop on Bankruptcy and Business Reorganization New York University School of Law; see also Samuel L. Bufford, 'Coordination of Insolvency Cases for International Enterprise Groups: A Proposal' (2012) 86 *Am. Bankr. L.J.* 685 p716 (says that 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.) Edward J. Janger, 'Virtual territoriality' (2009-2010) 48 *Colum. J. Transnat'l L.* 401p434; Robert W. Miller, 'Economic integration: An American solution to the multinational corporate group conundrum.' (2011-2012) 11 *Rich. J. Global L. & Bus.* 185 p213-214

could be easily identified under its current definition through the lens of a business network perspective.

## **5. A business network perspective of procedural consolidation**

Procedural consolidation needs to preserve the value of MCGs while respecting the CoMI test. However, if there is an inherent contradiction between these two values in that group achieve its group going concern value by allocated head office functions across group members, the efficacy of procedural consolidation is limited. This section will explore this issue in more details.

### **5.1 Group going concern value of MCGs**

European large corporate groups typically operate through the network of subsidiaries.<sup>46</sup> Internalization theory<sup>47</sup> provides useful insights to explain the boundaries of MCGs. 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.<sup>48</sup> Since the relationships among group members are different to and superior to arm's length market relationships, MCGs use control to connect

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<sup>46</sup>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

<sup>47</sup> Alan M. Rugman, 'Reconciling Internalization Theory and the Eclectic Paradigm' (2009) v18 (1)The multinational business review; Peter J. Buckley and Roger Strange, 'The Governance of the Multinational Enterprise: Insights from Internalization Theory' (2011) Journal of Management Studies 48 2

<sup>48</sup>Michael Galanis, 'Vicious spirals in corporate governance: mandatory rules for systemic (Re)balance?' (2011) Oxford Journal of Legal Studies, Vol. 31, No. 2 p331; see also Ronald Coase, 'The Nature of the Firm' (1937) 4 *Economica* 386–405.

members together.

EIR recast reflects this the control test by providing that: *'parent undertaking' means an undertaking which controls, either directly or indirectly, one or more subsidiary undertakings.*<sup>49</sup>Control could be obtained by a certain percentage of shareholdings or votes either directly or indirectly; or by a functional means such as ownership or contracts.<sup>50</sup>Therefore, 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.<sup>51</sup>This indicates that the relationships of group member companies in an MCG may be of great value.

This article believes that the value of relationships may consist of a large part of 'group going concern value'. It is generally believed that going concern value<sup>52</sup>may exist only when a company is kept intact and running.<sup>53</sup>In other words, an operating company may be worth more intact than if it is broken up.<sup>54</sup>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

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<sup>49</sup> EIR recast 2015 Art. 2

<sup>50</sup>UNCITRAL Legislative Guide on Insolvency Law—Part three p15

<sup>51</sup> Jean-Francois Hennart 'Theories of the multinational enterprise' in Alan M. Rugman, *The Oxford handbook of international business* (2nd Edition OUP 2009) p133

<sup>52</sup> 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](http://www.investopedia.com/terms/g/going_concern_value.asp)

<sup>53</sup> Douglas G. Baird, 'Bankruptcy's Uncontested Axioms' (1998-1999)108 Yale L.J. 573 p577

<sup>54</sup>Douglas G Baird and Robert K Rasmussen, 'The end of bankruptcy' (2002)55 Stan L rev 751 p758

stakeholders.<sup>55</sup>By analogy, the group going concern value can be defined as the value that only exists when most of the internal business relationships among group member companies are kept intact. Keeping the group intact is to a large extent to keep the relationships intact.

This argument can be further supported by resource-based theory and knowledge-based theory. They provide that in order to succeed in the market, companies should possess rare, valuable, non-substitutable and inimitable resources to gain advantages.<sup>56</sup>These valuable resources are not confined to valuable physical assets, but also include the knowledge to use resources and conduit to obtain knowledge and external opportunities.<sup>57</sup>That is to say, the knowledge and capacities to obtain resources are key for MCGs to gain advantages over rivals.<sup>58</sup>

It is important to note that many important innovations are achieved at the subsidiaries'

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<sup>55</sup>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

<sup>56</sup>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 competitive advantage' (1991) *Journal of Management*, 17 99-120. Christine Oliver, 'Sustainable Competitive Advantage: Combining Institutional and Resource-Based Views' (1997) *Strategic Management Journal*, Vol. 18, No. 9

<sup>57</sup>Sidney G. Winter, 'On Coase, Competence, and the Corporation,' (1988) *Journal of Law, Economics, and Organization*, 4 p175-177; DJ Teece, G Pisano and A Shuen, 'Firm Capabilities, Resources, and the Concept of Strategy,' (1990) Mimeo University of California at Berkeley, Haas School of Business. p11; Cyert, R. M, P. Kumar and J. R. Williams (1993), 'Information, Market Imperfections and Strategy,' *Strategic Management Journal*, Winter Special Issue, 14 p57; see generally, Kathleen R. Conner and C. K. Prahalad, 'A Resource-based Theory of the Firm' Knowledge Versus Opportunism' (1996) *Organization Science/VOI*. 7, No.5,

<sup>58</sup>Robert M Gant, 'Toward a knowledge-based theory of the firm' (1996) *Strategic Management Journal*, Vol. 17 p120



levels so that subsidiaries are strategic resources of the MCGs.<sup>59</sup> It is not enough to perform better than competitors in the global market solely relying on the strength of the parent company, so all the subsidiaries should contribute their knowledge learnt from the local environment to the MCGs.<sup>60</sup>In fact, foreign subsidiaries have better access to the information and country-specific advantages, such as technology and low cost of labour. The business relationships among group members allow other group members to understand the foreign environment and demand; learn and share with each other.<sup>61</sup>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.<sup>62</sup>That is to say, business networks are the pipes of information, resources, technologies and marketing between member companies, and they could be seen as important intangible resources of companies.<sup>63</sup>This network may be cut off by fragmented and uncooperative insolvency proceedings initiated in different member states.

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<sup>59</sup>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

<sup>60</sup> 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

<sup>61</sup> 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

<sup>62</sup>Ulf Andersson, Henrik Dellestrand, Torben Pedersen, 'The Contribution of local environments to competence creation in multinational enterprises' *Long Range Planning* 47 (2014) p95

<sup>63</sup>Mats Forsgren, *Theories of the multinational firm*, (Second edition, Edward Elgar publishing limited UK 2013) p108

From the above, one may argue that the relationships among members of MCGs may form group going concern value that should be preserved in cross-border insolvency. The next question is whether the value could be preserved by procedural consolidation on the basis of CoMI. This begs the question how the head office functions are allocated within MCGs as CoMI is the place where the head office functions of one company are carried out.

## 5.2 The allocation of head office functions inside MCGs

Business network perspective provides useful insights of the allocation of control in MCGs.<sup>64</sup>It focuses on the perspective of individual subsidiaries. The main tenet is that every subsidiary can be viewed as living in many idiosyncratic business networks consisting of internal and external fragmented environments.<sup>65</sup>Since the networks that one subsidiary formed either with internal group members or external partners in the market are of great value,<sup>66</sup>parent company's control on that subsidiary is contingent on

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<sup>64</sup>Mats Forsgren and others, 'Managing the embedded multinational--a business network view', (2006) Edward Elgar, Cheltenham UK; Bernard Surlemont, 'A typology of centers within multinational corporations: an empirical investigation' in Julian Birkinshaw, Neil Hood, *Multinational Corporate evolution and subsidiary development*, (Macmillan press London 1998); Mats Forsgren, *Theories of the multinational firm*, (Second edition, Edward Elgar publishing limited UK 2013); Ulf Andersson, Mats Forsgren and Ulf Holm, 'Balancing Subsidiary Influence in the Federative MNC: A Business Network View' (2007) *Journal of International Business Studies*, Vol. 38, No. 5; Håkan Håkansson and Ivan Snehota, *Developing Relationships in Business Networks*, (1995) Routledge London; Kirsten Foss and others, 'MNC organisational form and subsidiary motivation problems: controlling intervention hazards in the network of MNC'(2011) available at: <http://ssrn.com/abstract=1969402>

<sup>65</sup>Mats Forsgren, *Theories of the multinational firm*, (Second edition, Edward Elgar publishing limited UK 2013) p107

<sup>66</sup>Networks may form relational economic rents which cannot be gained by regular market relationships. 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, p662

the power of the overall networks of that subsidiary.<sup>67</sup> 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.<sup>68</sup>

This especially true as subsidiaries' roles are changing and expanding 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.<sup>69</sup> Even though parent companies may acquire control through their ownership,<sup>70</sup> 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.<sup>71</sup> 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 existence of and the importance of the hierarchical structure of MCGs, but in reality, the control in MCGs is allocated by bundles of idiosyncratic and heterogeneous business networks rather than institutional

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<sup>67</sup> Mats Forsgren, *Theories of the multinational firm*, (Second edition, Edward Elgar publishing limited UK 2013) p108 p118-119

<sup>68</sup> Mats Forsgren, et al, *managing the embedded multinational--a business network view*, (Edward Elgar, cheltenham UK 2006) p133

<sup>69</sup> Ram Mudambi et al 'How subsidiaries gain power in multinational corporations' (2014) *Journal of World Business* 49 p109

<sup>70</sup> 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

<sup>71</sup> Mo Yamin, Ulf Andersson 'Subsidiary importance in the MNC: What role does internal embeddedness play?' (2011) *International Business Review* 20 p153

hierarchies.<sup>72</sup>

Research has shown that relatively decentralised subsidiaries are more likely to learn and create value.<sup>73</sup>The relatively 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 a fierce competition.<sup>74</sup>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. Therefore, there may be more than one head office in a given MCG with different head office functions spread across different levels.

One thing worth mentioning is that CoMI location analysis entails a comprehensive consideration of all relevant factors. Therefore, even though in some cases, parent companies can control the financial arrangements of all the subsidiaries, one cannot conclude that parent companies have ultimate control of subsidiaries. Put briefly, certain subsidiaries may control the research and development function which is at least equally important as the financial function. In fact, one research shows that technology-related head office functions can arguably yield the strongest control.<sup>75</sup>As a result, focusing on

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<sup>72</sup> Mats Forsgren, *Theories of the multinational firm*, (Second edition, Edward Elgar publishing limited UK 2013) p116

<sup>73</sup> Kirsten Foss et al, 'MNC organisational form and subsidiary motivation problems: controlling intervention hazards in the network of MNC'(2011) available at: <http://ssrn.com/abstract=1969402> p6

<sup>74</sup> Kirsten Foss et al, 'MNC organisational form and subsidiary motivation problems: controlling intervention hazards in the network of MNC'2011 available at: <http://ssrn.com/abstract=1969402> p6

<sup>75</sup>Ram Mudambi et al 'How subsidiaries gain power in multinational corporations' *Journal of World Business* 49 (2014) p109

only finance-related factors run against the principles of case law which requires a comprehensive analysis of all objective factors that are ascertainable to creditors.<sup>76</sup> It is more likely that the idiosyncratic and heterogeneous business networks of each subsidiary in one group confer every subsidiary different head office functions so that no clear group CoMI of that group can be found.

With the above finding in mind, the next section will consider how this will affect procedural consolidation.

### **5.3 Problems of procedural consolidation**

At this stage, it is possible to examine whether procedural consolidation offers a good solution to the insolvency of MCGs on the basis of CoMI test. Here it is important to note one distinction between whether EIR recast allows procedural consolidation and whether procedural consolidation can achieve the goals it aims to achieve. Even if EIR recast allows procedural consolidation, it does not justify it in all circumstances.

Admitted that in the cases where 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.<sup>77</sup> One well-known case regarding procedural consolidation is the Daisytek case<sup>78</sup> where the parent companies Daisytek ISA in the UK opened insolvency proceedings for its sixteen subsidiaries in different European member states. The UK court considered the scale and importance of the interests of creditors of subsidiaries and the court confirmed that

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<sup>76</sup> Re Stanford [2010] EWCA Civ 137; Interdil case [2012] B.C.C. 851

<sup>77</sup>Heribert Hirte, "Towards a framework for the regulation of corporate groups' insolvencies" 5 ECFR 213 2008 p220; see also Christoph Paulus, "Group Insolvencies - Some Thoughts about New Approaches", (2007) 42 Texas Int'l L.J. p819-820

<sup>78</sup>Re Daisytek-ISA Ltd [2004] B.P.I.R. 30.

the UK was the place of CoMI of all those European subsidiaries.<sup>79</sup>One can also argue that EIR recast still allows procedural consolidation.<sup>80</sup>However, this says nothing about whether procedural consolidation can offer a good balance between preservation of group going concern value and certainty.

One should not assume that all the courts may seize insolvency jurisdiction in good faith by conducting a CoMI analysis for all subsidiaries.<sup>81</sup>It has been argued that the insolvency courts be biased to decide CoMI or even compete for the insolvency jurisdiction; the courts are more likely to act in favour of managers and other allies rather than the unsecured creditors.<sup>82</sup>As big cases are usually lucrative, the courts and insolvency practitioners cannot be expected to give them up to other jurisdictions.<sup>83</sup>

We can also witness that some scholars call for attaching great importance to registered place test by making it difficult to be rebutted.<sup>84</sup>This is the emphasis of the goal of certainty in cross-border insolvency law context.<sup>85</sup>Back to the *Daisytek* case, though it seems that English court conducted a procedural consolidation based on CoMIs analysis

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<sup>79</sup>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 p457

<sup>80</sup> Michele Reumers, 'What is in a Name? Group Coordination or Consolidation Plan—What is Allowed Under the EIR Recast?' (2016) Int. Insolv. Rev. Vol. 25

<sup>81</sup>Matteo M. Winkler, 'From Whipped Cream to Multibillion Euro Financial Collapse: The European Regulation on Transnational Insolvency in Action' (2008) 26 Berkeley J. Int'l L. 352 p369

<sup>82</sup> Lynn M. LoPucki, *Courting failure: How Competition for Big Cases is Corrupting the Bankruptcy Courts* (The University of Michigan Press 2006) p243

<sup>83</sup>ibid p221

<sup>84</sup>Gerard McCormack, 'COMI and comity in UK and US insolvency law' (2012) Law Quarterly Review, p7; Dario Latella, 'The "COMI" Concept in the Revision of the European Insolvency Regulation' (2014) European Company and Financial Law Review 11(4) p479-494

<sup>85</sup>Jay L. Westbrook 'Locating the eye of the financial storm' (2006-2007) 32 Brook. J. Int'l L. 1019 p1032

for all companies involved, <sup>86</sup>there is no uniform standard of the analysis. Which factors should be given more weight when considering CoMI? And how many factors in one location can determine CoMI?

Only in the MCGs whose business are neatly centrally controlled and integrated, <sup>87</sup>it is possible to achieve similar results like Daisytek case. However, business network perspective of MCGs shows an inherent contradiction between group going concern value and the allocation of head office functions. That is, the group going concern value is achieved by means of spreading head office functions across subsidiaries. Based on current understanding of CoMI, procedural consolidation may not preserve group going concern value by pulling other subsidiaries into one jurisdiction on the one hand and provide certainty to local creditors who may well perceive that the local subsidiaries are undertaking certain head office functions on the other hand. Procedural consolidation changes the applicable law to those creditors, so even though a centralized group rescue plan can bring a larger pie to creditors, the uncertainty caused by such practice may give rise to an increase of interest rate to the society.

It is true that creditors or debtors may move CoMI to one country for the purpose of procedural consolidation. Using forum shopping as a method to achieve procedural consolidation is dangerous for several reasons. The foremost one is that when forum shopping happens at operating companies' level, it may destroy group going concern value. From a business network perspective, the relationships between subsidiaries and their external environment 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 as they can absorb foreign countries' specific advantages. The movement of real CoMI

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<sup>86</sup>Gabriel Moss QC, 'Group insolvency-forum-EC Regulation and model law under the influence of English pragmatism revisited' (2014-2015) 9 Brook. J. Corp. Fin. & Com. L. 179 p186

<sup>87</sup>Irit Mevorach, 'Cross border insolvency law of enterprise groups: the choice of law challenge' (2014) 9 Brook. J. Corp. Fin. & Com. L. 107 p6

may change the environment where foreign subsidiaries are embedded and cut off their conduits to gain foreign resources and capacities. As a result, a transfer of real 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.

When procedural consolidation via forum shopping happens at holding level, the problems of above may dwindle.<sup>88</sup> Holding companies may only have institutional secured creditors to take care and more importantly, they do not have a complicated location-bound external environment. In fact, it has been seen some MCGs insolvency cases happened at holding levels, especially involving the pre-pack sale of operating companies.<sup>89</sup>

However, certain foreign insolvency law procedures such as pre-pack administrations may benefit senior creditors at the expense of junior ones.<sup>90</sup> The Wind Hellas case is an 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

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<sup>88</sup> Jennifer Payne, *Scheme of arrangement, Theory structure and operation*, (Cambridge University Press 2014) p322

<sup>89</sup> In the Matter of Christophorus 3 Limited, [2014] EWHC 1162 (Ch); Barclays Bank Plc v HHY Luxembourg Sàrl [2011] 1 B.C.L.C. 336

<sup>90</sup>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' (2006) Recovery summer 16 p17 (Cited by Vanessa Finch Corporate insolvency law perspectives and principles (Second edition Cambridge university press 2009) p456



consolidation as six companies in the group transferred CoMIs to the UK.<sup>91</sup>The result attracted heavy criticism as it left the unsecured creditors with 1.5 billion Euros unpaid.<sup>92</sup>The motive of the senior creditors moving companies to the UK may be suspicious as it can be said to going around the contractual protection to junior creditors provided by inter-creditor agreement.<sup>93</sup>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. The whole process was also suspiciously rigged by debtors, since some information was only available to the successful bidder but not to others.<sup>94</sup>Therefore, procedural consolidation by forum shopping should be subject to close scrutiny. Also, as above-mentioned, if it happens at the level of operating companies, the result may be far more harmful.

It seems a better direction of development is to design debt restructuring rules to facilitate MCGs reaching rearrangements with senior creditors at the holding companies' level while keeping the operating subsidiaries intact. The aim is to avoid group-wide insolvency or at least allow the operating group to be transferred to new buyers without the need of forum shopping. Nonetheless, this solution needs to make sure that insolvency jurisdiction is respected and adequate protection is granted to junior financial creditors.

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<sup>91</sup>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.

<sup>92</sup>M Rustein, L Bloomberg, 'A wind blow through an English brothel'. (2010) CRI P156

<sup>93</sup>Inter-creditor agreement does not allow security agents to release principal and interests of inter-company debts between Wind Hellas and other holding companies. See Christian Pilkington and others, 'Wind Hellas a complex restructuring in global recession' (2011) Practical Law Publishing Limited.

<sup>94</sup>Re Hellas Telecommunications [2009] EWHC 3199 (Ch) p5

## **6 Conclusion**

As the above analysis indicates, procedural consolidation may contain inherent drawbacks in solving cross-border insolvency issues for MCGs. Though cost may be reduced by centralizing the insolvency proceedings of subsidiaries to their ultimate parent's one, the cost from the uncertainty may outweigh the benefits of centralization. Among other things, the main difficulty arises from the fact that MCGs achieve an important part of their group going concern value by spreading head office functions across member companies, which cripples the basis of procedural consolidation in that it may not achieve preservation of value and certainty at the same time.