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A recommendation to improve the opt-out mechanism in EU Regulation on insolvency proceedings recast

Daoning Zhang, Ph.D.
daoningzhang@gmail.com

Abstract

This article provides a recommendation to improve the opt-out mechanism in the group coordination proceedings in EU Regulation on insolvency proceedings recast (EIR recast).[1] This recommendation aims to encourage cooperation of insolvency practitioners of group member companies and prevent abusive strategies of senior creditors.

1. Introduction

The EIR recast is a fairly new rule which has not yet come into effect.[2] It provides a general cooperation and coordination legal framework which improve certainty and possibility to preserve the value of multinational corporate groups(MCGs). However, 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.

This article will first provide an overview of group coordination proceedings. Secondly, it analyzes the ability of group coordination proceedings to preserve group

[1] The new group coordination proceeding in EIR recast is the first formal cross-border insolvency framework which specifically deals with cross-border insolvency of multinational corporate groups. Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings

[2] It shall apply from 26 June 2017 see Art. 92 EIR recast

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 price 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. Finally, it offers a modest recommendation which works as a constraint on the invocation of the opt-out mechanism in group coordination proceedings.

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.[3]Substantive and procedural consolidation may cause uncertainty to creditors as these mechanisms all cause changes of insolvency law in an international context. Retaining the status quo on the other hand may cause a multinational corporate group fall into pieces so that the economic value of the group will be more likely lost.

EIR recast[4]does not take a huge leap towards adopting substantive or procedural consolidation.[5] Rather, it adopts a modest way by adding one group chapter into the

[3]Gerard McCormack, 'Reforming the European insolvency regulation: a legal and policy perspective' P57

[4]Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings

[5] Stephan Madaus, 'Insolvency proceedings for corporate groups under the new Insolvency Regulation' 2015 p3 at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2648850

EIR recast focusing on coordination and cooperation among practitioners and courts.

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.[6]In the EIR recast, a new Chapter V prescribes specifically group coordination proceedings for cross-border insolvency of corporate groups.[7]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.

Chapter V retains the 'communication and cooperation obligations' of courts and insolvency practitioners.[8] 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.[9]

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[10] can be proposed by a coordinator appointed by any court in which the

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[6] Reinhard Bork Renato Mangano, *European cross-border insolvency law* OUP Oxford 2016 P291

[7] Chapter V of EIR recast

[8] 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.'

[9] Chris Howard, Bob Hedger, *Restructuring and law & practice,* LNUK *2014*

[10]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.'

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.[11]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.[12]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.[13]

The coordinator[14]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.[15]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.[16]Coordinators therefore enjoy the power

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[11] Stephan Madaus, 'Insolvency proceedings for corporate groups under the new Insolvency Regulation' 2015 p10 at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2648850;

[12] EIR recast Art. 70

[13] 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, Stuart Isaacs QC, The EU Regulation on insolvency proceedings third edition OUP Oxford 2016 P516

[14] EIR recast Art.72 (2) e

[15] EIR recast Art 72

[16] 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 (i)(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.

to make stay to resolve this problem either in the case of group reorganization aiming for recovery or a group sale of assets.[17]

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.[18]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.[19]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 group value, but can also provide certainty.[20]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.

2Problems 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

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[17] 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 Oxford 2016 P516

[18] EIR recast Art 63(b)

[19] See EIR recast Recital 58 and see also Reinhard Bork Renato Mangano, *European cross-border insolvency law* OUP Oxford 2016 p294

[20] Group coordination proceedings respect entity law, it does not pool the assets and claims of different group members together.

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.

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.[21]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.[22]

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.[23]Also, rejection of inclusion has an automatic effect without any restrictions from the court which opens group coordination proceedings.[24]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.

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[21] EIR recast Art.64

[22] Christoph Thole, and Manuel Dueñas, 'Some Observations on the New Group Coordination Procedure of the Reformed European Insolvency Regulation'Int. Insolv. Rev., Vol. 24 (2015) p224; 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; Jessica Schmidt, 'Group insolvency under the EIR recast' Eurofenix Autumn 2015

[23]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

[24] Gabriel Moss QC, Ian. Fletcher QC, Stuart Isaacs QC, *The EU Regulation on insolvency proceedings* Third Edition OUP Oxford 2016 P510

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.[25]The EIR is based on entity law, and therefore, each subsidiary's interests should be protected.[26]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.[27] 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.[28] In the context of group insolvency, respecting each subsidiary is a basic requirement confirmed by the ECJ *Eurofood* case[29].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.[30]Similarly, the office-holders such as

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[25] Jessica Schmidt, 'Group insolvency under the EIR recast' Eurofenix Autumn 2015 p18

[26] 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.

[27]Samantha Bewick, 'The EU Insolvency Regulation, Revisited' Int. Insolv. Rev. (2015) P17 see also Michael Weiss, 'Bridge over Troubled Water: The Revised Insolvency Regulation' Int. Insolv. Rev. (2015)

[28] Such as reducing risks, encouraging investment, mitigating transaction cost. see F. Easterbrook and D. Fischel, 'Limited Liability and the Corporation', 52 University of Chicago Law Review (1985) p. 89 see also Irit Mevorach, 'The Role of Enterprise Principles in Shaping Management Duties at Times of Crisis' European Business Organization Law Review Volume 14Issue 04 2013 p477

[29] Eurofood [2006] Ch.508

[30] Irit Mevorach, 'The Role of Enterprise Principles in Shaping Management Duties at Times of Crisis' European Business Organization Law Review Volume 14Issue 04 2013 p480

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.[31]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;[32]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 plan vulnerable to the strategic actions of some creditors or investors. The next section will provide a further discussion on this issue.

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,[33]group insolvency cases may in fact only involve one or more

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[31] Sch. B1 para 3(2); see also Ian Fletcher, *The law of insolvency*, 4th Edition Sweet & Maxwell London 2009 p568

[32]Burkhard Hess, Paul Oberhammer, Thomas Pfeiffer, *European insolvency law Heidelberg-Luxemburg-Vienna report* Hart Publishing Oxford 2014 P222

[33] Isabel Giancristofano, 'Third party securities in the financial restructuring of corporate groups In Germany. International corporate rescue 13(2) 2016 p111

holding companies.[34]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; [35]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 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.

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.[36]It is entirely possible that the

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[34] 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' South square digest 2015 p2

[35] Proposals for the revision of the European Insolvency Regulation – a step forward in the rescue culture? Linklaters 2012 p4

[36]Michelle M Harner, Jamie Marincic, 'Behind Closed Doors: The Influence of Creditors in Business Reorganizations' 34 Seattle U. L. Rev. 1155 2010-2011p1158

senior creditors could expect a sale of business to other buyers or own it by themselves.[37]

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. [38]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.[39]

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-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. [40] 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

[37] Michelle M Harner, Jamie Marincic, 'Behind Closed Doors: The Influence of Creditors in Business Reorganizations' 34 Seattle U. L. Rev. 1155 2010-2011p1158

[38]Oscar Couwenberg, Stephen J. Lubben, 'Essential Corporate Bankruptcy Law' University of Groningen Faculty of Law Research Paper Series No. 04/2013p8-9 p15

[39]George G. Triantis, 'A Theory of the Regulation of Debtor-in-Possession Financing' 46 Vand. L. Rev. 901 1993 p903

[40]Gerard McCormack, 'Super-priority new financing and corporate rescue' Journal of Business Law 2007 p8

be used to secure their pre-insolvency debts as well.[41]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. [42]

Another thing that may happen may be that certain investors have the incentives to control or own the subsidiaries in their own interests.[43] 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 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.

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[41] Charles J. Tabb, 'A critical reappraisal of cross-collateralization in bankruptcy' 60 S. Cal. L. Rev. 109 1986-1987 p112

[42] 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' Journal of Business Law 2007 p13

[43] Michelle, M. Harner, 'Activist investors, distressed companies, and value uncertainty'22 Am. Bankr. Inst. L. Rev. 167 2014

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.

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. [44]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.

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[44]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' 25 Cardozo L. Rev. 1905 2003-2004 P1917

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.[45] 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.[46]Such control may bring in the benefit of better decision-making due to certain creditors' information advantages.[47]

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 concern value. Such decision is better to allow the creditors and the debtors who have the information to decide.

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[45]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' Insolvency and Restructuring International Vol 10 No 1 March 2016p37

[46] Douglas G. Baird& Robert K. Rasmussen 'Private debt and the missing lever of corporate governance' 154 U. Pa. L. Rev. 1209 2005-2006 p1217

[47]Douglas G. Baird& Robert K. Rasmussen 'Private debt and the missing lever of corporate governance' 154 U. Pa. L. Rev. 1209 2005-2006 p1219

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. [48] DIP lenders may abuse their power to require debtors to conduct a fire sale of the business as a pre-requisite of financial support.[49]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. [50]

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

[48] Douglas G. Baird, Robert K. Rasmussen, 'Chapter 11 at twilight' 56 Stan. L. Rev. 673 2003-2004 p697

[49] George W Kuney, 'Hijacking Chapter 11' 21 Emory Bankr. Dev. J. 19 2004-2005 p108

[50] David A. Skeel, Jr, 'Creditors' ball: the "new" new corporate governance in Chapter 11' 152 U. Pa. L. Rev. 917 2003-2004 p941-942

part of insolvency law which, if applied properly, have significant value. For example, refinancing options can resolve the insolvency-specific issue--debt overhang. [51]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.[52]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, a modest solution is to consider the possibility of improving the group coordination proceedings under the existing provisions.

3 Recommendations

3.1 The aim of the opt-out mechanism

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.[53]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.

[51] 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 & David A. Skeel Jr. ' Bankruptcy Law as a Liquidity Provider' 80 U. Chi. L. Rev. 1557 2013 p1571

[52]George G. Triantis, 'A Theory of the Regulation of Debtor-in-Possession Financing' 46 Vand. L. Rev. 901 1993 p911-912

[53] Recital 54-57 EIR recast 2015

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.[54] On the other hand, group coordination proceedings provide a framework for the group companies to cooperate and coordinate together via a group plan at the behest of the same coordinator. However, 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 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 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.

[54] Certainty is the not only merit of group coordination proceedings, but also the requirement of insolvency law.

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. 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 fixed.[55] However, to avoid the above issue, the opt-out mechanism requires something more than that. As long as group members have different views regarding rescue, and the creditors' profiles are varying, the coordination proceeding seems to be vulnerable to the anti-commons issue that insolvency law is designed to resolve. Without any method of dealing with anti-commons, the purpose of insolvency law such as maximization of the value of the debtor's insolvency estate 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

[55]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' 25 Cardozo L. Rev. 1905 2003-2004 P1907

on more information and have more rescue options by comparing the group plan and individual plans.

For the purpose of maximization of value for creditors, insolvency practitioners need to consider all the options available to the companies. The options include 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. 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.

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 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[56] and limited

[56] 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' International corporate rescue 13(1) 2016 p35

marketing.[57]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.

Therefore, it is not easy to respect an individual company for certainty on the one hand and preserve group going concern value on the other hand. How to strike this balance will be considered in the next section.

3.2 The balance of group option and individual option

Since parent companies may allocate certain head office functions to their subsidiaries, subsidiaries may have better information than parent companies in regard to how to use such power and how to keep subsidiaries operating in viable ways. 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. Similarly, coordinators and group bidders may have better information regarding the value of the whole group. The information they possess 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. Firstly, 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. Secondly, local insolvency practitioners' information may be used to prevent one individual subsidiary from being undervalued by the potential bidders for the whole group.

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[57] Tom Astle, ' Pack up your troubles: addressing the negative image of pre-packs' Insolvency Intelligence 2015 p1-2

Thirdly, information of coordinators or group bidders can prevent local senior creditors from talking down the value of subsidiaries they control.

Local senior creditors or investors who decide to opt-out of the group coordination proceedings may have 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.

One limitation of the invocation of the opt-out mechanism can be found in current provisions under the EIR recast to deal with the above undesirable situation. The EIR recast prescribes that insolvency practitioners in each subsidiary shall exchange information and consider the possibilities of coordination plans and restructuring plans.[58] Also, other insolvency practitioners should be informed at an early stage of the main content of coordination for the purpose of coordination proceedings.[59]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 as insolvency practitioners in each member company of the same group have obligation

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[58] EIR recast Article 56.

[59] EIR recast Recital 56

to consider the possibilities of a group plan at the time of considering the individual rescue plan. They therefore need to communicate and inform the other insolvency practitioners of other member companies regarding the individual plan at an early stage.

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[60] requires the administrator to decide whether it is appropriate to conduct a pre-pack sale for the creditors in general rather than the managers or purchasers.[61]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.[62]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

[60] Statement of practice 16 issued on 01 November 2015 by R3: Association of Business Recovery Professionals

[61] Statement of practice 16 issued on 01 November 2015 by R3: Association of Business Recovery Professionals P2

[62] Statement of practice 16 issued on 01 November 2015 by R3: Association of Business Recovery Professionals p2 and p4

assets of the debtor to the purchaser before the creditors meeting.[63]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.

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.[64]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. [65]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.[66] Also, the direction of the US pre-pack regulation seems to be

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[63]Brief guide to Administration, Linklaters at www.linklaters.com/pdfs/Insights/banking/Guidetoadministration.pdf 2008 p3

[64] Anthony. Wijaya, 'Pre-Pack Administration Sale: a Case of Sub Rosa Debt Restructuring' Int. Insolv. Rev., Vol. 25 2016 p130

[65] 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' 16 Bankr. Dev. J. 37 1999-2000 p61

[66] 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

towards a focus on enhanced protection to creditors in general. [67] However, whether the sale is the best solution is a commercial judgment, so that the supervisory role of the courts are limited.[68]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 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.

The group plan may help to reveal the value of 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

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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.

[67]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 Weijs, Bob Wessels, 'Proposed Recommendations for the Reform of Chapter 11 U.S. Bankruptcy Code', Amsterdam Law School Legal Studies Research Paper No. 2015-14p11

[68] 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?' Journal of Business Law 2015p3

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.[69]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.[70]More plans and discussions based on the information so disclosed would make the reorganization more transparent.[71]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.[72]Coordinators could be seen as neutral parties[73]who facilitate the group option and monitor the undesirable individual rescue options.

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.

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[69]Horst Eidenmüller, Kristin van Zwieten, 'Restructuring the European Business Enterprise: The EU Commission Recommendation on a New Approach to Business Failure and Insolvency' ECGI Working Paper 301/2015 P13

[70] Harvey R. Miller, 'Chapter 11 in Transition -From Boom to Bust and Into the Future' 81 Am. Bankr. L.J. 375 2007 p384

[71] Michelle M Harner, Jamie Marincic, 'Behind Closed Doors: The Influence of Creditors in Business Reorganizations' 34 Seattle U. L. Rev. 1155 2010-2011 p1181

[72] Michelle M Harner, Jamie Marincic, 'Behind Closed Doors: The Influence of Creditors in Business Reorganizations' 34 Seattle U. L. Rev. 1155 2010-2011 p1182

[73] 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 P6

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. 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.