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Intra-group financial support in a crisis: between rescue and abuse

Abstract

Traditionally, insolvency law has been treating companies atomistically. This approach is underpinned by the doctrine of separate legal personality, which recognises and respects separateness of a company from its shareholders. However, modern economic reality leads to the creation of global interconnected and interdependent economic enterprises – groups comprising of dozens or even hundreds of legal entities, spanning across national borders. In light of this, the strict entity-by-entity approach could lead to suboptimal outcomes. In case of a financial crisis and insolvency, it may result in a piecemeal liquidation and disintegration of otherwise viable but distressed business. In this article I attempt to overcome this limited "singular" vision by analysing the issue of intra-group financial support. I show that current rules applicable to intra-group financial transactions (i.e. intra-group loans, cross-guarantees and provision of collateral) greatly vary among European jurisdictions and may generally disincentivise value creating financial support in times when it is most needed. The recently adopted EU Restructuring Directive, while bringing some harmonisation to the otherwise diverging transaction avoidance rules, and supporting rescue financing, does not alleviate this complexity, but may actually worsen it.

By relying on the principle-based approach and taking the EU bank recovery and resolution framework as a reference point, I propose supplementing the existing European regulatory regime with special rules to facilitate intra-group financial support, while establishing necessary safeguards against (group) opportunistic behaviour. This article primarily concentrates on the EU area. Nevertheless, its findings may be equally relevant for the treatment of global enterprise groups, with EU and non-EU group members facing financial distress and requiring group-wide crisis prevention and resolution.

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Table of contents

1. Introduction 3
2. Group restructuring and insolvency law principles 5
2.1. Principles of (international) insolvency law 5
2.1.1. Equal treatment of creditors 6
2.1.2. Optimal realisation of debtor's assets 7
2.1.3. Protection of trust and certainty of transactions 7
2.2. Principles of insolvency law and distressed groups of companies 8
3. Directive on preventive restructuring frameworks 10
3.1. Background and aims of the Directive 10
3.2. Role and regulation of rescue financing 11
3.3. Protection of interim and new financing in the Directive 12
4. Transaction avoidance rules in corporate groups 14
4.1. Internal v. external creditors divide 15
4.2. Rescue support between group members 16
4.2.1. Financial support by a non-distressed group member 17
4.2.2. Financial support by a distressed group member 19
5. Bank Recovery and Resolution Directive and intra-group financial support 20
5.1. Principles and goals of bank resolution 21
5.2. Intra-group financial support under the BRRD 23
5.2.1. Purpose of the BRRD regime for intra-group financial support 25
5.2.2. Main characteristics of group financial support agreements 25
5.2.3. Pros and cons of the BRRD group financial support framework 28
6. Between creditor protection and group interest 29
6.1. Financial support by a non-distressed group member 30
6.2. Financial support by a distressed group member 31
7. Protection of rescue financing and third country perspective 34
8. Conclusion 35

1. Introduction

Intra-group financial arrangements are frequently driven by global or regional business plans, strategies on the international (holding), regional (sub-holding) and domestic (entity) levels and implementation and execution of certain group-wide policies. These and other commercial (e.g. tax, regulatory) reasons determine corporate, organisational and financial outlook of an enterprise group. For instance, a group may have special entities responsible for raising capital (i.e. special purpose financing vehicles), operating companies, companies holding particular valuable assets or business lines. When a group member is in need of working capital, it may be funded via an intra-group loan or supported by another group member providing a guarantee or collateral. Intra-group financial transactions are a part of the modern business reality. If we imagine an enterprise group as a human body, intra-group financing can be compared to blood that circulates throughout the body, supporting the variety of its functions.

Problems

While the group as a whole is solvent, there are very few limitations on the type and nature of financial transactions that group members may enter into. Constraints on related-party transactions may, for instance, follow from rules of company and securities law.[1] However, it is insolvency law that inhibits the free flow of capital within the group the most. This is the case where either the lender/guarantor and/or the borrower enters the vicinity of insolvency or insolvency proceedings. Transactions between group members often have a high chance of being avoided or subordinated in insolvency.[2] There are **two major problems** relating to this.

1) The first, general problem arises from the lack of harmonisation in transaction avoidance and claim subordination rules across the European Union (EU) Member States, as well as outside the EU. This is despite the understanding that “a higher degree of harmonisation in the field of restructuring, insolvency […] is […] indispensable for a well-functioning internal market.”[3] The application of different transaction avoidance and claim subordination rules complicates intra-group financial support in a crisis, creates legal uncertainty and may lead to additional transaction costs.

2) The second, more specific problem, and the focus of this article, concerns the need to encourage and protect interim and new financing (hereinafter “rescue financing”) in restructuring.[4] Despite empirical evidence favouring the use of rescue financing,[5] many

[1] For an overview of strategies used to constrain related-party transactions see Luca Enriques, Gerard Hertig et al. ‘Related-Party Transactions’ in Reinier Kraakman, John Armour et. al. (eds), *The Anatomy of Corporate Law: A Comparative and Functional Approach* (OUP 2017) 145-169; Luca Enriques, ‘Related Party Transactions: Policy Options and Real-World Challenges (with a Critique of the European Commission Proposal)’ (2015) 16 EBOR 1.
[2] This is usually done to protect the interests of creditors of the entities involved. See Alessio Pacces, ‘Procedural and Substantive Review of Related Party Transactions (RPTs): The Case for Non-Controlling Shareholder-Dependent (NCS-Dependent) Directors’ (2018) 399/2018 ECGI Working Paper Series in Law, arguing that “substantive ex-post review tends to over-deter [related-party transactions] as it leads courts to second-guess, with hindsight bias, the decision to enter into RPTs.”
[3] Recital 8, European Parliament legislative resolution of 28 March 2019 on the proposal for a Directive of the European Parliament and of the Council on preventive restructuring frameworks.
[4] Different jurisdictions and soft law instruments use different names to characterise this form of financing. The Directive uses the terms “interim and new financing”. In the USA a common term “debtor-in-possession financing” is prevalent. The UNCITRAL Legislative Guide on Insolvency Law adopts the name “post-commencement finance”.
[5] S Dahiya, K John, M Puri and G Ramírez, ‘Debtor-in-possession financing and bankruptcy resolution: Empirical evidence’ (2003) 69 J. Financ. Econ. 259; U Dhillon, T Noe and G. Ramírez, ‘Debtor-in-possession financing and the resolution of uncertainty in Chapter 11 reorganizations’ (2007) 3 J. of Fin. Stability 238. The World Bank Doing

EU Member States lack special rules on the matter, which in light of the above problem discourages efficient rescue attempts. If a multinational corporate group is compared to a human body, rescue financing is a targeted transfer of resources from one organ to another for the purposes of saving its functions, and possibly the survival of the body as a whole.

Research questions

In November 2016, the European Commission (EC) published a proposal for a Directive on preventive restructuring frameworks.[6] The Proposal resulted in the Directive 2019/1023 that was adopted in summer 2019 (Directive).[7] The Directive aims to solve both problems described above by mandating the creation of preventive restructuring frameworks in all EU Member States. It also contains rules related to the protection of new and interim financing, which seek to facilitate the extension of rescue support to ailing companies. In light of the adoption of the Directive, this article poses **two questions**:

1) Does the intra-group financial support fit within the Directive's preventive restructuring framework and its regime for new and interim financing?

2) Assuming intra-group support could facilitate rescue of failing groups and benefit their creditors, what should the most appropriate regulatory framework look like? Should intra-group support transactions be considered at a single entity level or should the group interest be taken into account as well?

Methodology

The article aims to answer these questions by embracing a **principle-based approach**, which sanctions the analysis of the applicable or proposed rules through the prism of legal principles.[8] The choice of this methodology is premised on the understanding that cross-border group financial distress triggers complex legal, financial and factual issues, which are not always possible to conceptualise or codify in rules. As opposed to rules, principles aim at establishing broad standards of practice and behaviour. They are a powerful instrument to interpret the existing regulation, but also a tool to balance various (conflicting) interests, e.g. interests of different group entities and their creditors. No less important is the capacity of legal principles to serve as guidelines for future reforms, and act as facilitators of legal harmonisation.[9] While not embracing a rigorous comparative analysis, I complement the principle-based approach with periodic references to different legal systems. This should enhance our understanding of what happens "on the ground" and how legal principles are pursued in national law.

Business Report (2016) 102. See also L Stanghellini, R Mokal, C Paulus and I Tirado (eds), *Best Practices in European Restructuring. Contractualised Distress Resolution in the Shadow of the Law*, (Wolters Kluwer 2018) 60, with references to Italian qualitative and quantitative analysis highlighting importance of rescue financing in distress.

[6] Proposal for a Directive on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures, COM(2016) 723 final.

[7] Directive (EU) 2019/1023 of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications.

[8] On the use of principle-based approach in legal research see Reinhard Bork, *Principles of Cross-Border Insolvency Law* (Intersentia 2017). Commenting on this book, Wessels wrote that "principle-based approach provides inspiration for evaluating research and may lead to reconsider proposals for shaping and improving cross-border insolvency law." See Bob Wessels blog from 2 October 2017.

[9] Bork (n 8) 19-20.

Article structure

This article is structured as follows. The next section (Section 2) briefly describes the selected substantive principles of international insolvency law and their relevance in group insolvency. Section 3 introduces the Directive and the protective regime for interim and new financing created by it. Section 4 discusses specific aspects of transaction avoidance in corporate groups. It presents two scenarios of intra-group rescue financing in insolvency and concludes that due to largely divergent approaches to related-party transactions and in the absence of harmonised rules on intra-group financial support, a situation of legal uncertainty for internal financiers persists. As an example of such harmonised rules, the article takes a closer look at the Bank Recovery and Resolution Directive (BRRD)[10] and its uniform group financial support approval and authorisation mechanism (Section 5). Based on this experience, Section 6 seeks ways to improve or supplement the Directive with a group financial support framework, to encourage efficient rescue attempts, on the one hand, and protect the interests of creditors, on the other. While the article has an EU-focus, it acknowledges that in reality most international groups of companies have group members established outside the EU area. In light of this, Section 7 discusses how the effectiveness of a group financial support framework can be guaranteed in the context of large multinational enterprise groups with group members established outside the EU. Section 8 concludes.

2. Group restructuring and insolvency law principles

2.1. Principles of (international) insolvency law

This article embraces the definition of legal principles as "fundamental and basic standards"[11] or "meta-norms".[12] This entails the distinction between principles, on the one hand, and rules and policies, on the other. As opposed to rules and policies, principles have a higher level of abstraction and are arguably more stable. To be accepted as a principle, a standard must be widely and lastingly recognised.[13] It can be implemented in a variety of rules, often in different areas of law.[14] Nevertheless, societal and economic background may affect the importance assigned to or relative weight of a legal principle, or its position in case of a conflict with another principle.[15] It may also cause new principles to appear and substitute or supplement the existing ones. Thus, legal principles are not set in stone and develop over time.

Bork has systemized and divided cross-border insolvency law principles into three broad categories: jurisdictional principles, procedural principles and substantive principles.[16] Jurisdictional principles deal with the relations between sovereign states and include such

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[10] Directive 2014/59/EU of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms.
[11] Bork (n 8) 13.
[12] John Pottow, 'Greed and Pride in International Bankruptcy: The Problems of and Proposed Solutions to 'Local Interests', (2006) 104 Mich. L. Rev. 1899.
[13] See Article 38(1)(c) of the Statute of the ICJ, among the sources of international law listing "the general principles of law recognized by civilized nations."
[14] For example, the principle of protection of legitimate expectations and certainty of transactions justifies special treatment of rights *in rem*, both in the context of property, contract and insolvency law. This principle is further evidenced in concrete rules, for instance, in Article 8 of the European Insolvency Regulation (recast), which in certain circumstances insulates rights *in rem* from the effects of *lex concursus*.
[15] See Ronald Dworkin, 'The Model of Rules' (1967) 35 U Chi L Rev 14, 27.
[16] Bork (n 8) 16-17.

principles as unity, universalism, mutual trust, communication and cooperation in insolvency cases, and others. Procedural principles relate to organisation of the insolvency procedure and consider its efficiency, transparency, predictability and procedural fairness. Most of these principles are not specific to insolvency and apply to general (civil) procedure. The third category is substantive principles. These principles are unique, as they reflect the influence of insolvency on substantive rights and the legal position of parties involved (e.g. creditors, debtors, shareholders and employees). Among substantive principles, 1) equal treatment of creditors (*pari passu*), 2) best possible realisation of the debtor's assets (estate value maximization) and 3) protection of legitimate expectations, sometimes referred to as protection of trust. The choice of these principles for further analysis and application is determined by their relevance to the subject of this article, namely intra-group financial (rescue) support.

2.1.1. Equal treatment of creditors

Pari passu is the principle, according to which "similarly situated creditors are treated and satisfied proportionately to their claim out of the assets of the estate available for distribution to creditors of their rank."[17] This principle is linked to the idea of equality[18] and is considered a centrepiece of insolvency law.[19] *Pari passu* is closely related to the collective enforcement regime provided by insolvency law. This collectivism should lead to the reduction of strategic costs and the increase of the collective pool of assets to the extent that it prevents a race to the court, individual enforcement of claims and piecemeal liquidation.[20] The principle of equal treatment of creditors permeates national laws,[21] EU legislation[22] and various soft law instruments.[23]

Some level of detail should be provided on the operation of the equality principle. UNCITRAL refers to the equal treatment of "creditors of the *same class*"[24] and the World Bank promotes "equitable treatment of *similarly situated* creditors."[25] This is a restrictive interpretation of the principle, which fits the current insolvency law reality, where creditors are treated in accordance with their priority rankings. Mokal[26] and other scholars[27] have noted the diminished role of the

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[17] UNCITRAL Legislative Guide on Insolvency Law (UNCITRAL Guide on Insolvency Law), Parts I and II (2004).
[18] See Ronald Dworkin, *Taking Rights Seriously* (HUP 1977) 180, describing a right to equality as "a right to equal concern and respect in the design and administration of the political institutions that govern them."
[19] CERIL, 'Clash of Principles: Equal Treatment of Creditors vs. Protection of Trust in European Transaction Avoidance Laws' (2017) para. 14; R Goode, *Principles of Corporate Insolvency Law*, (3rd edn, Sweet & Maxwell 2005) 175; Andrew Keay and Peter Walton, 'The preferential debts regime in liquidation law: in the public interest?' (1999) 3 C.F.I.L.R. 84.
[20] Thomas Jackson, *The Logic and Limits of Bankruptcy Law* (HUP 1986) 16-17, viewing the role of insolvency law as one of "ameliorating a common pool problem created by a system of individual creditor remedies." See also Horst Eidenmüller, 'What is an insolvency proceeding?' (2016) 335/2016 ECGI Working Paper Series in Law, arguing that only fully collective proceedings should be qualified as insolvency proceedings.
[21] See e.g. Section 107 Insolvency Act 1986 (England and Wales); Article L643-8 Commercial Code (France); Section 226 Insolvency Act (Germany).
[22] Article 23(2) EIR Recast; Recital 13 BRRD; Recital 12 Directive 2001/24/EC of 4 April 2001 on the reorganisation and winding up of credit institutions (CIWUD).
[23] UNCITRAL Guide on Insolvency Law, 2004; Financial Stability Board, 'Key Attributes of Effective Resolution Regimes for Financial Institutions' (2011) para. 5.1; The World Bank, 'Principles for Effective Insolvency and Creditor/debtor Regimes'(2015) C1.
[24] UNCITRAL Guide on Insolvency Law (2004) 360.
[25] The World Bank (n 23).
[26] Rizwaan Mokal, 'Priority as Pathology: The *Pari Passu* Myth' (2001) 60(3) Camb. Law J. 581, 582, arguing that the principle is "less important than it is sometimes made out to be, and does not fulfil any of the functions often attributed to it."
[27] David Skeel, 'The Empty Idea of "Equality of Creditors"' (2018) 166 Univ. Pa. Law Rev. 699, 701, noting that "Bankruptcy courts often bless arrangements that give one group of general creditors starkly different treatment than other groups."

principle. According to them, the erosion of this principle manifests itself in the plethora of priorities created by insolvency law, as well as other tools, such as set-off, which may create de facto preferences for some creditors. Without entering into the debate about the true nature and the role of the *pari passu* principle, it suffices to say that the equality of creditors is relative, rather than absolute.[28]

2.1.2. Optimal realisation of debtor's assets

The collective nature of the insolvency process contributes to the attainment of another principle of insolvency law – optimal realisation of debtor's assets. This principle entails the achievement of the maximum value of assets, which shall ultimately "facilitate higher distributions to creditors as a whole and reduce the burden of insolvency."[29] It is important to stress the stand-alone value of this principle and to emphasise that it does not serve a subordinate role to other principles, such as *pari passu*.

Maximization of insolvency estate can be achieved with the help of provisions on transaction avoidance, prohibition of *ipso facto* clauses and protection of rescue financing. Such provisions aim at preserving and safeguarding the value of the estate (e.g. prohibition of *ipso facto* clauses or set-off) or enriching the insolvency estate (e.g. transaction avoidance, claims against (former) directors and officers).

2.1.3. Protection of trust and certainty of transactions

Insolvency is a foreseeable risk. With few exceptions, no business is immune from insolvency.[30] It is therefore important that creditors and debtors are able to calculate insolvency-related risks, particularly if a transaction is concluded at the time when a debtor is in financial distress but not yet insolvent.

The power of insolvency practitioners and/or creditors to challenge pre-insolvency transactions "limits the ability of debtors to engage in the transactions in the first instance."[31] This could be damaging if such transactions are value-creating and can lead to the optimal realisation of the estate value.[32] More broadly, the breach of the principle of trust may create disproportionate social costs in the form of foregone transactions, higher interest rates (limiting access to credit), increased screening (due diligence) costs and protracted litigation. The need to protect

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[28] In Case C-156/15 *'Private Equity Insurance Group' SIA v. 'Swedbank' AS* [2016], the CJEU ruled that conferral on the financial collateral takers the right to enforce the collateral notwithstanding the commencement of insolvency proceedings in respect of the collateral provider did not breach the *pari passu* principle. The court thus confirmed that the equality was relative rather than absolute.

[29] UNCITRAL Guide on Insolvency Law (2004) 10. For a critical view on insolvency privileges see Christoph Paulus, 'Multinational Enterprises and National Insolvency Laws: Lobbying for Special Privileges' (2018) 29 Eur. Bus. Law Rev. 393.

[30] For example, a situation of "insolvency-proofness" existed in France as applied to establishments of an industrial and commercial character (EICC, or EPIC in their French acronym), such as La Poste. In French administrative law, EPICs are legal entities governed by public law that have distinct legal personality from the state. The status of EPIC entailed a number of legal consequences, including the inapplicability of insolvency and bankruptcy procedures under ordinary law. As a result, creditors of La Poste always had an implied and unlimited state guarantee that their unpaid claims would not be cancelled. This immunity from insolvency was, however, considered to be a source of (unlawful) state aid within the meaning of Article 87(1) EC. See Case C-559/12 *French Republic v. European Commission* [2014].

[31] Douglas Baird, Thomas Jackson, 'Fraudulent Conveyance Law and its Proper Domain' (1985) 38 Vand. L. Rev. 829, 834.

[32] Steven Schwarcz, 'Collapsing Corporate Structures: Resolving the Tension Between Form and Substance' (2014) 60 The Business Lawyer 109, 110, noticing that "[w]hen economically beneficial transactions are prevented, all parties suffer."

legitimate expectations and the certainty of transactions has resulted in various rules and mechanisms.[33]

2.2. Principles of insolvency law and distressed groups of companies

For historical, economic and political reasons, resolution of financial distress has traditionally been carried out on a country/entity level, frequently ignoring the group context.[34] In other words, rules of insolvency (but also company) law had a single-entity (i.e. single debtor) in mind, thus largely lacking provisions related to groups of companies. For instance, neither the CIWUD, nor the original EIR[35] provide for coordination of insolvency proceedings opened against members of the same enterprise group.[36] Neither does the UNCITRAL Model Law on Cross-Border Insolvency (1997).

The adoption of the EIR Recast in 2015,[37] the BRRD in 2014 and the UNCITRAL Model Law on enterprise group insolvency (MLG) in 2019 signify a new stage in the development of modern insolvency law as applied to corporate groups. The question is – can the principles of international insolvency law discussed above be effective at this new stage? In my opinion, there are no reasons for such principles to lose their salience and become irrelevant. However, the realisation of such principles in the context of an integrated corporate group requires certain readjustments and careful balancing. Before explaining why this is the case, a brief introduction to what a "group of companies" is should be made.

There is no universal definition of a corporate group. For instance, the EIR Recast defines a "group of companies" as a parent undertaking and all its subsidiary undertakings.[38] The MLG characterises an "enterprise group" as "two or more enterprises that are interconnected by control or significant ownership."[39] Mevorach has developed a comprehensive typology of multinational groups of companies, depending on their level of centralization, organizational integration and interdependence.[40] While some groups may consist of relatively self-sufficient business units (e.g. responsible for separate product/industry lines), which can survive on their own, others are notable for running a single enterprise. It is the latter type of integrated corporate groups that deserves special attention in insolvency, since the failure of one group member can be contagious and lead to the domino fall of all other group members. The absence of a group-wide solution to financial distress may result in a piecemeal liquidation of assets and suboptimal returns to creditors. Therefore, for example, the pursuit of the principle of optimal realisation of insolvency estate may be dependent on the availability of a combined group-level solution. The synergy between group members may be lost, should their assets

[33] Among the most prevalent safeguards against transaction-avoidance in insolvency are suspect periods, "ordinary course of business" exception, requirements of certain mental elements (e.g. intent, awareness), debtor's substantive insolvency at the time of the transaction. See also CERIL, 'Reversal of Value Extraction Schemes' (2019).

[34] Samuel Bufford, 'Coordination of Insolvency Cases for International Enterprise Groups: A Proposal' (2014) 1-2014 Penn State Law Research Paper 22.

[35] Council Regulation (EC) No. 1346/2000 of 29 May 2000 on insolvency proceedings.

[36] According to the Bank for International Settlements (BIS), the global financial crisis has illustrated the shortcomings of the current bank resolution regime and in particular the "absence of a process for the coordinated resolution of the legal entities in a financial group or financial conglomerate," thereby limiting the chances of "coordinated resolution of such cross-border groups or conglomerates." BIS, 'Report and Recommendations of Cross-border Bank Resolution Group' (2010) 24.

[37] Regulation (EU) 2015/848 of 20 May 2015 on insolvency proceedings.

[38] Article 2(13) EIR Recast.

[39] UNCITRAL Model Law on Enterprise Group Insolvency (2019).

[40] Irit Mevorach, *Insolvency within Multinational Enterprise Groups* (OUP 2009) 135-147.

be sold on a separate basis.[41] This adds a layer of complexity to the operation of the principle of value maximisation.

An alternative, restructuring route appears more preferable. Restructuring may be understood as a survival of a legal entity and its core economic functions or sale of business as a going concern. It usually involves both operational and financial adjustments, including changes in corporate strategy, cost reductions, asset sales, debt-to-equity swaps, issuance of new capital, etc.[42] In a group context, such adjustments have to apply to several or the majority of legal entities within the group. This may touch upon the interests of various groups of creditors of each legal entity involved. In the absence of substantive consolidation, equal treatment of creditors must be maintained and preserved with respect to each separate group entity. In other words, intra-group creditor equality does not exist.[43]

The UNCITRAL Legislative Guide on Insolvency Law (Part III) distinguishes two types of regulation applicable to corporate groups: 1) separate entity approach (by far the most prevalent) and 2) single enterprise approach.[44] Mevorach refers to them as “entity law” and “enterprise law” respectively.[45] The entity approach relies on the principle of separate legal personality of each member comprising the group. Thus, insolvency estates and pools of creditors are separated. This limits the risks attached to one-company-failure. However, economic interconnectedness of group members, facilitated by the diverse intra-group financial arrangements, could make such an approach less appealing. In contrast, the enterprise approach treats the group as a single economic entity that operates to further the interests of the group as a whole. This latter approach has given rise to various rules and techniques, from less intrusive (e.g. communication and cooperation between insolvent group members) to the ultimate disregard of entity boundaries – substantive consolidation. The enterprise approach could be particularly useful when interpreting intra-group transactions, as it “can allow a better understanding of the true nature of the transaction and the commercial reality surrounding it.”[46] A seemingly unreasonable transfer of funds to a distressed company may be justified by the interests of the enterprise group as a whole, which may ultimately (positively) contribute to the value received by creditors of the group members involved.

Lastly, the acknowledgement of the existence and the role played by the economic enterprise may be necessary for the protection of legitimate expectations of the parties contracting with group members. Such parties might be under the impression that the group as a whole stands behind the transaction, the perception further intensified by the commonality of a brand,

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[41] This is what happened in the insolvency of KPN Qwest, a telecom group, which owned and operated rings of fibre-optic cable around Europe and the USA. The parts of the cable were owned by different group entities. When the Dutch holding company failed, its subsidiaries were forced into insolvency and their assets were sold on a separate basis. This result was suboptimal as the value of the ring was much higher compared to the value of its detached sections.

[42] Jason Harris, ‘Class warfare in debt restructuring: does Australia need cross-class cram down for creditors’ schemes of arrangement?’ (2017) 36(1) U Queensland LJ 73, 76.

[43] Even the BRRD, which, as explained below, considers the group context and group interest in addressing resolution of financially distressed banks, mandates the application of the no-creditor-worse-off principle on an entity-by-entity basis. No application of this principle is authorised at the group level. See Single Rulebook Q&A, Question ID 2015_2458.

[44] UNCITRAL Legislative Guide on Insolvency Law, Part III (2010) 16.

[45] Irit Mevorach, ‘Transaction Avoidance in Bankruptcy of Corporate Groups’ (2011) 8 ECFR 235, 243-244.

[46] Ibid 246.

endorsement of the transaction by other group members, consolidated financial statements, intra-group guarantees and cross-collateralisation of debt.[47]

3. Directive on preventive restructuring frameworks

3.1. Background and aims of the Directive

Despite the unification of private international law rules in the area of insolvency in the EU (i.e. EIR Recast, CIWUD), substantive insolvency law has largely remained in the hands of national legislators. As a result, a patchwork of insolvency rules, divided by national borders, remained. It has soon become clear that cross-border business and the increasingly interconnected single market, facilitated by the development of digital technologies, needed a predictable, harmonised and efficient insolvency law regime.[48] Creation of such a regime is the major goal of the Directive. As noted above, the proposal for the Directive was made by the EC in 2016. The European Parliament formally voted on the Directive on 28 March 2019, and on 6 June 2019, it was adopted by the Council. This marked the end of the legislative process. EU Member States now have two (and in certain cases - three) years to implement the provisions of the Directive in national laws.

The key element of the Directive is the creation of preventive restructuring frameworks, allowing debtors to access early restructuring tools and to solve their financial distress before actual insolvency. The nature of these restructuring frameworks is not entirely clear. On the one hand, they should be available for debtors in financial difficulties when there is only a *likelihood* of insolvency.[49] In the absence of insolvency, limited court involvement,[50] debtor-in-possession and contractual debt restructuring seem logical. On the other hand, the Directive contains tools, typical for ordinary insolvency proceedings and addressing common pool and hold out problems, such as class formation, best interest of creditors test, cross-class cram-down and stay of individual enforcement actions. This duality allowed some commentators to conclude that "the Commission proposes a twisted and truncated Chapter 11 style insolvency proceeding, not a "preventive restructuring framework"[51] and that "in terms of its consequences, the procedure is nothing but an insolvency procedure."[52] The embrace by the Directive of traditional insolvency law features justifies the application of insolvency law principles to preventive restructuring procedures.

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[47] Kannan Ramesh, 'Synthesising Synthetics: Lessons learnt from Collins & Aikman', 2nd Annual GRR Live New York (2018) para 22.

[48] Commission Recommendation of 12 March 2014 on a new approach to business failure and insolvency, C(2014) 1500/F1. This recommendation approved creation of frameworks that enable efficient restructuring with the objective of preventing insolvency. Operation of such frameworks centred around negotiations on and adoption of restructuring plans, protection of new financing and discharge of debts for honest entrepreneurs. The Commission evaluated the effects of the recommendation and concluded that it has only been partially implemented, see Evaluation of the Implementation of the Commission Recommendation of 12.3.2014 on a New Approach to Business Failure and Insolvency, 30 September 2015. As a result, it was decided to convert the recommendation into binding legislation. See Action Plan on Building a Capital Markets Union, COM(2015) 468 final.

[49] Article 1(1)(a), Article 4(1) Directive.

[50] This should contribute to the reduction of delays and costs of the procedures, see Recital 29, Article 4(6) Directive.

[51] Horst Eidenmüller, 'Contracting for a European Insolvency Regime' (2017) 18 EBOR 273, 290.

[52] NWA Tollenaar, 'The European Commission's Proposal for a Directive on Preventive Restructuring Proceedings' (2017) 30(5) Insolvency Intelligence 65, 71. For a different view on insolvency v. restructuring law divide see S Madaus, 'Leaving the Shadows of US Bankruptcy Law: A Proposal to Divide the Realms of Insolvency and Restructuring Law' (2018) 19 EBOR 615.

3.2. Role and regulation of rescue financing

The Directive contains provisions protecting interim and new financing. As explained in its Recital 66, "[t]he success of a restructuring plan often depends on whether financial assistance is extended to the debtor to support, firstly, the operation of the business during restructuring negotiations and, secondly, the implementation of the restructuring plan after its confirmation." It is frequently the case that ailing businesses need additional (oftentimes urgent) liquidity to pay back its trade and finance creditors, while negotiating a restructuring plan. The failure to secure financing may trigger defaults and cross-defaults and cause a breakup of commercial relations with critical suppliers of goods and services, complicating the negotiation process and disrupting potential restructuring plans. Besides, applicable law may contain an obligation to file for insolvency in case of liquidity shortages (cash-flow insolvency).[53]

The situation is further aggravated by high commercial and legal risks involved in providing funds to or extending a guarantee in favour of a distressed company. For this reason, laws of several EU jurisdictions introduce incentives for lenders to extend credit to a financially troubled company. Such incentives usually comprise of protection against avoidance actions and priority granted to rescue financiers over other unsecured or even secured creditors. The rules related to recue financing are adopted in Spain,[54] France,[55] Greece[56] and Slovenia[57]. However, the majority of the EU Member States do not have special provisions on rescue financing.[58]

A notable example of a jurisdiction with detailed rules on rescue financing (referred to as debtor-in-possession financing, or DIP financing) is the United States. The Directive has been strongly influenced by the codified statutory language of the US Bankruptcy Code and its ability to prime the DIP financing.[59] The relevant provisions of the Bankruptcy Code can be found in Section 364(a), under which post-commencement financing obtained in the ordinary course of business is granted administrative priority, ranking ahead of pre-bankruptcy unsecured claims. If the credit needs to be obtained outside the ordinary course of business, a prior court approval after a notice and a hearing is required.[60] The raking of post-commencement claims *pari passu* with other administrative claims was considered not to be very attractive for rescue financiers. This is why a super priority status was offered, which allows a court to grant priority "over any or all administrative expenses."[61] If a debtor cannot obtain credit with the superiority administrative expense status, the Bankruptcy Code grants a possibility to authorize security in the form of a lien on property that is not otherwise subject to a lien[62] or even a lien equal to

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[53] See e.g. Section 64 Law on limited liability companies (Germany); Section 69(2) Insolvency Act (Austria); Article 21(a) Insolvency Law (Poland).
[54] Article 84.2.11 Insolvency Act (Spain).
[55] Article L. 611-11 Commercial Code (France).
[56] Article 154(a) Bankruptcy Code (Greece).
[57] Article 273 of the Financial Operations, Insolvency Proceedings, and Compulsory Dissolution Act (ZFPPIPP) (Slovenia).
[58] See G McCormack et al., 'Study on a new approach to business failure and insolvency' (2016) at 167. For a country-by-country overview of rescue financing rules, see B Wessels, RJ de Weijs (eds), *International Contributions to the Reform of Chapter 11 U.S. Bankruptcy Code* (Eleven International Publishing 2015) 105-145.
[59] For an overview of the US legislation on DIP financing, see J Payne and J Sarra, 'Tripping the Light Fantastic: A Comparative Analysis of the European Commission's Proposals for New and Interim Financing of Insolvent Businesses' (2018) 27 Int. Insolv. Rev. 178. The special treatment of post-petition financing in the USA can be traced back to the 19th century, when lenders were given special priority for financing reorganisation efforts (often for distressed railroads companies). See David Skeel, 'The Past, Present and Future of Debtor-in-possession Financing' (2004) 25 Cardozo L. Rev. 1905.
[60] 11 U.S. Code § 364(b).
[61] 11 U.S. Code § 364(c).
[62] 11 U.S. Code § 364(c)(2).

or senior to existing liens ("priming liens"). The latter is rather extraordinary and requires proof that the debtor is unable to obtain credit otherwise[63] and that there is adequate protection of the interest of the holder of the lien on the property of the estate on which such senior or equal lien is proposed to be granted.[64]

A number of empirical studies have concluded that companies with DIP financing were more likely to successfully emerge from Chapter 11 compared to those which did not receive rescue finance.[65] DIP-financed companies also had a shorter reorganisation period, leading to the increase in the value of the debtor's assets. Importantly for this article, the studies also showed that financing by existing and insider lenders was related to faster resolution of the Chapter 11 process, partially explained by better information awareness of "internal" financiers about the debtor's future prospects, as compared to the outside (external) lenders.[66] In the USA DIP financing represents an important source of funding to distressed companies and offers a solution to the "debt overhang" problem, when even the positive net profit value projects remain underinvested, since the pay-offs from such projects are absorbed by or shared with the existing (pre-petition) creditors.[67] The Commission to Study the Reform of Chapter 11, established by the American Bankruptcy Institute has also recognised the need "for a robust, competitive postpetition financing market and the value it provides to distressed companies."[68] An effective framework facilitating rescue financing should contribute to achieving the principle of asset value maximisation, introduced above.[69]

3.3. Protection of interim and new financing in the Directive

The Directive focuses on addressing, what it considers, "the most important problems that could be feasibly addressed by harmonisation."[70] One of these problems is the protection of interim and new financing, which the Directive seeks to establish and harmonise across all EU Member States. It follows the justification adopted in the USA that rescue financing is vital for business continuity during restructuring negotiations and the implementation of restructuring plans. This Section introduces the scope of the protective regime imposed by the Directive and traces its development from the original proposal. Unless specifically indicated, all references to the Directive are references to its final text, as adopted in June 2019.

The Directive acknowledges that national insolvency rules providing for the avoidance of rescue finance transactions or establishing civil, administrative or criminal liability for extending credit to debtors in financial distress inhibit value-creating rescue financing. As a response, the

[63] 11 U.S. Code § 364(d)(1)(a).
[64] 11 U.S. Code § 364(d)(1)(b).
[65] See n 5. Also F Elayan, T Meyer, 'The Impact of Receiving Debtor-in-Possession Financing on Probability of Successful Emergence and Time Spent Under Chapter 11 Bankruptcy' (2001) 28(7) & (8) J Bus Finance Account 905, 906, indicating that "there is a direct relation between Chapter 11 firms operating with DIP loans and successful reorganisation."
[66] Dahiya (n 5) 262.
[67] S Gilson, 'Coming Through a Crisis: How Chapter 11 and the Debt Restructuring Industry Are Helping to Revive the U.S. Economy' (2012) 24 J. Appl. Corp. Finance 23, 28; G Triantis, 'Debtor-in-Possession Financing in Bankruptcy' in Adler (ed), *Research Handbook on Corporate Bankruptcy Law* (2017) Stanford Public Law Working Paper 7, available at SSRN.
[68] ABI Commission to Study the Reform of Chapter 11, Final Report and Recommendations (2014) 77.
[69] This is further supported by the World Bank' Strength of Insolvency Framework Index, which measures the efficiency of insolvency legislation. Among other criteria, it considers whether the insolvency framework includes specific provisions that allow the debtor to obtain financing (i.e. post-commencement finance) necessary for the business continuation and to grant such financing priority over ordinary unsecured creditors.
[70] Proposal for Directive (n 6).

Directive mandates protection of rescue financing from avoidance actions and shields its guarantors from personal liability.[71] The Directive distinguishes interim and new financing. "Interim financing" means financial assistance granted during negotiations of a restructuring plan. Such assistance must be "reasonable and immediately necessary for the debtor's business to continue operating, or to preserve or enhance the value of that business."[72] The lack of interim financing may result in cash flow insolvency and disrupt the restructuring negotiations. "New financing" refers to financial assistance provided in order to implement a restructuring plan and that is included in that restructuring plan.[73] Thus, new financing follows negotiations of the restructuring plan and requires incorporation in the restructuring plan and subsequent confirmation by a judicial or administrative authority. As opposed to interim financing, new financing is usually provided for a longer period of time,[74] and may involve larger amounts of funds to restore the debtor's economic and operational value.

The proposal for the Directive was first published in November 2016. Since then the text has undergone serious revision, mainly to guarantee more flexibility for EU Member States to tailor its application to local economic and social conditions and interests.[75] As concerns provisions on interim and new financing, a few notable changes and additions should be mentioned.

1) The General Approach of the European Council[76] dated 1 October 2018 (GA) clarified that financial assistance to distressed companies should be understood broadly and include provision of new money and third-party guarantees, as well as supply of stock, inventory, raw materials and utilities.[77] Thus, the term "interim and new financing" has been broadened to include various forms of financial assistance, in addition to monetary credit. These other forms equally fall under the protective regime of rescue financing.

2) The GA has introduced different options for regulation of interim and new financing. In particular, it establishes that Member States may restrict protection afforded to rescue financing to cases, where "the plan is confirmed by a judicial or administrative authority or the interim financing was subject to *ex ante* control." This brings clarity in terms of arrangements open for EU Member States to consider.

3) Most importantly for this article, the GA in Recital 31 added that the Directive shall not affect "other grounds for declaring new and interim financing void, voidable or unenforceable or for triggering civil, criminal or administrative liability for providers of such financing, as provided for by national law". As to such "other grounds", the GA mentioned fraud, bad faith and "a certain type of relation between the parties which

[71] This article refers to interim and new financing as "rescue financing", as the ultimate goal of such financing is to give a chance to a struggling debtor to continue operating and survive or be sold as a going concern.
[72] Article 2(8) Directive.
[73] Article 2(7) Directive.
[74] It has been suggested that the timeframe for the implementation of a restructuring plan should be no longer than 3-5 years. A long implementation phase faces market uncertainty and is usually less accurate in terms of the forecasting. See Stanghellini (n 5) 101.
[75] Directive on business insolvency: Council agrees its position, Press release of the Council of the EU, 11 October 2018 <https://www.europa-nu.nl/id/vksim5mwlcz7/nieuws/directive_on_business_insolvency_council> accessed 8 February 2020.
[76] In the EU legislative framework, the European Commission has the right of legislative initiative. Thus, it was the EC that proposed the Directive in 2016. Then the Council and the Parliament propose amendments and adopt the legislative proposal either at the first reading or at the second reading. Sometimes the Council also uses a "general approach" to give the Parliament an idea of its position on the legislative proposal.
[77] Recital 31, Proposal for Directive, General approach, 1 October 2018.

could be associated with a conflict of interest such as in the case of *transactions between related parties or between shareholders and the company*."[78] The legislative history of the Directive reveals that several EU Member States have expressed particular concerns about extending the Directive's protective regime to transactions between the debtor and connected persons. These include Finland[79] and Italy.[80] Following the Council, the European Parliament has largely taken over the text of the GA, including the said carve out from the protection of interim and new financing.[81] This carve out puts into question the applicability of the regime for protection of new and interim financing to all intra-group financial support arrangements.

The next Section discusses the possible rationale behind this recent addition to the Directive and the reasons why it might go against the goals of the Directive, as well as the balanced application of the principles of international insolvency law.

4. Transaction avoidance rules in corporate groups

Transaction avoidance rules are typically found in national insolvency laws. As summarised in the CERIL report, "[s]ome of them are designed to provide sanctions against fraudulent behaviour or transactions at an undervalue, whereas others aim to enforce the principle of equal treatment of creditors (*par condicio creditorum*) by enabling the insolvency practitioner to challenge the preferential treatment of a creditor."[82] While provisions targeting certain transactions concluded before or after the opening of insolvency proceedings are common, significant differences remain in the details, conditions and legal consequences of such avoidance.

The prospect of facing different transaction avoidance rules is claimed to be by far the most relevant disincentive to enter into restructuring negotiations with the debtor.[83] Restructuring becomes even more complicated in the context of corporate groups, where streams of funds are repeatedly transferred across corporate entities and geographical boundaries. Sections 4.1. and 4.2. below introduce the multitude of approaches to transactions between related or affiliated parties characteristic of corporate groups and of high relevance in the context of rescue financing.

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[78] This phrase is mentioned for the first time in the note drawn up jointly by the Austrian Presidency and the incoming Romanian Presidency, taking into account the written suggestions from the country delegations, 26 July 2018 <https://data.consilium.europa.eu/doc/document/ST-11405-2018-INIT/en/pdf> accessed 8 February 2020.

[79] Compilation of Member States' written comments on Article 2(6)-(12), Article 8-18, 11 October 2017, with Finnish comment: "In our opinion, the transactions involving closely connected parties should be left outside the scope of Article 16 entirely and into national discretion" <https://data.consilium.europa.eu/doc/document/ST-13121-2017-INIT/en/pdf> accessed 8 February 2020.

[80] Compilation of Member States' written comments on Article 2(6)-(12), Article 8-18, 7 November 2017, with Italian comment that Member States may set specific rules for financing from partners, "providing for reduced protection in cases where partners should have re-capitalised rather than financed the company <https://data.consilium.europa.eu/doc/document/ST-13121-2017-ADD-1/en/pdf> accessed 8 February 2020.

[81] Proposal for the Directive. Confirmation of the final compromise text with a view to agreement, 17 December 2018 <https://data.consilium.europa.eu/doc/document/ST-15556-2018-INIT/en/pdf> accessed 8 February 2020.

[82] CERIL, 'Clash of Principles: Equal Treatment of Creditors vs. Protection of Trust in European Transaction Avoidance Laws' 2017/1(2017) para 2.

[83] Stanghellini (n 5) 22.

4.1. Internal v. external creditors divide

Despite the proclaimed equality of creditors, the reality is much more complicated. In the vast majority of EU Member States, insolvency laws establish special treatment for transactions involving related parties, such as directors, shareholders and their affiliates, sometimes referred to as “insiders”. Such insiders usually enjoy lesser, minimal or no protection against transaction avoidance. This materialises in the extension of suspect periods,[84] acceptance of certain mental elements[85] or a rebuttable presumption of the harm caused to creditors.[86]

In addition to the relaxation of requirements for transaction avoidance, a number of jurisdictions adopt special rules concerning shareholder loans. The most notable example is Germany, where, as a general rule, claims arising from loans provided by shareholders and directors are subordinated, i.e. downgraded in the ranking of claims.[87] This significantly increases risks for shareholders, directors and other affiliated parties who wish to provide funding to a distressed company. The doctrine of subordination is also applied in Austria, Sweden, Portugal, Spain, Slovenia, Italy and Poland.[88] In economic terms, the effects of applying this doctrine are similar to avoidance of related-party transactions. Both aim at protecting non-related creditors. Both are based on presumptions or objective (straightforward) criteria. Both may disincentivise related parties from providing financing to companies in a crisis. It is therefore important to investigate why internal creditors are treated differently from external creditors.

There are several notable characteristics that distinguish internal (related) creditors from external (non-related creditors). The first major distinction concerns the information asymmetry between the two groups of creditors. Internal creditors (e.g. shareholders, directors) have an advantage of access to internal information of the debtor, including its financial documentation. They “tend to have the earliest knowledge of when the debtor is, in fact, in financial difficulty.”[89] This allows them to “plan” for insolvency, ultimately making such creditors better risk bearers. Secondly, shareholders exercise control over the debtor.[90] Because of this, and together with

[84] For instance, in England and Wales the suspect period for preference transactions is two years for connected persons, compared to otherwise applicable 6-month period, see Section 240, UK Insolvency Act 1986. In Estonia, gratuitous transactions can be revoked if concluded within one year before the appointment of an interim trustee. This period is extended to five years if the donee was a person connected to the debtor. See Section 111 Bankruptcy Act (Estonia).

[85] According to sec. 131(2) German Insolvency Code, a person with a close relationship to the debtor on the date of [preference] transaction (sec. 138) shall be presumed to have been aware of the disadvantage to the creditors in insolvency proceedings. Under sec. 239 UK Insolvency Act 1986, a company which has given a preference to a person connected with the company “is presumed […] to have been influenced in deciding to give it by such a desire as is mentioned in subsection (5).” [desire to create advantage to a counterparty]. In Greece, avoidance of preferences requires knowledge of the counterparty about the detrimental effects of the transactions. Such knowledge is presumed for connected persons, see Article 43(2) Bankruptcy Code (Greece). The knowledge of prejudice in related-party transactions is codified in Article 43(1)(3,4,5) Bankruptcy Act (Netherlands).

[86] Article 71 Insolvency Act (Spain).

[87] Sec. 39(1)(5) Insolvency Act (Germany).

[88] McCormack (58) 124-125.

[89] UNCITRAL Guide on Insolvency Law (2004) para 182.

[90] It must be acknowledged that in companies with dispersed shareholding, the real influence of (minority) shareholders on corporate decision-making may be limited. Traditionally, the UK and the USA are regarded as dispersed shareholding jurisdictions, whereas jurisdictions of the continental Europe are considered as having concentrated shareholding structures. While generally correct, this constitutes a generalisation that ignores important differences among EU Member States and the rising role of institutional investors. See P Davies, K Hopt, R Nowak and G van Solinge (eds), *Corporate Boards in Law and Practice: A Comparative Analysis in Europe* (OUP 2013) 6. Generally speaking, the percentage of shareholding is not always a good predictor of actual control. See L Bebchuk, R Kraakman and G Triantis, ‘Stock Pyramids, Cross-Ownership, and Dual Class Equity: The Creation and Agency Costs of Separating Control from Cash Flow Right’ (2000) 249 Harvard Law and Economics Discussion Paper, exploring “controlling minority structures.”

the enhanced knowledge, they can control the shift of assets to other group entities, effectively abandoning the distressed company and harming ordinary creditors. In other words, internal creditors can abuse their position.[91] Thirdly, risk appetite of internal creditors (i.e. shareholders) can be higher compared to non-related parties, since in insolvency shareholders' claims may rank lower than claims of general unsecured creditors, while limited liability shields them from claims of the debtor's creditors. This gives them additional economic incentives to pressurize management to pursue risky or reckless transactions or otherwise behave opportunistically.[92]

4.2. Rescue support between group members

Judging from the perspective of insolvency law principles, facilitation of intra-group support in a situation of financial distress can optimize (maximize) the value of the insolvency estate of the group as a whole. The sole fact that financing is provided by an internal creditor does not change this. By applying a formal economic model to subordination, which, as noted above, has effects similar to transaction avoidance, Gelter concluded that subordination "deters some desirable rescue attempts and is an insufficient deterrent for some undesirable ones."[93] Shareholder loans can be value-maximizing if they are used to finance efficient restructuring attempts. It is true that the internal position of shareholders can be abused to finance inefficient restructuring attempts or to syphon the assets to group members to the detriment (out of reach) of external creditors. Nevertheless, the carve out of all intra-group support from the Directive's rescue financing regime appears too broad and indiscriminate.[94] It does not seem to be balanced or justified and may disproportionally harm the principle of estate value maximization.

As to other principles of insolvency law, such as equal treatment of creditors and protection of trust, the following should be said. If we understand the principle of equality in a narrow sense, as equal treatment within the same class of creditors (e.g. position of UNCITRAL and the World Bank), then uplifting the position of shareholder claims to a position of unsecured creditors (from an otherwise subordinated position) or to a rank above such creditors, would not lead to an unequal (non-pro rata) distribution within classes themselves. Roe and Tung, while critical of what they call "priority jumping", argue that priority granted to a rescue lender "is unexceptional. It is not priority jumping, but a practice of long standing: New credit often commands special priority."[95] The fact that this practice is not as common in Europe as it is in the United States can be explained by the catching-up development of the European

[91] Dammann notes that "intragtoup transactions can be difficult to police and are therefore potentially prone to abuse", see J Dammann, 'Related Party Transactions and Intragroup Transactions' in L Enriques and T Tröger (eds), *The Law and Finance of Related Party Transactions* (CUP 2019) 219.

[92] See L Stout, 'The Mythical Benefits of Shareholder Control' (2007) 93 Va. L. Rev. 789, 790. See also Millon, noting that limited liability can facilitate opportunistic behaviour by shareholders, and arguing for a sound policy to prevent the use of limited liability "as a device deliberately or recklessly to extract value from third parties." D Millon, 'Piercing the Corporate Veil, Financial Responsibility, and the Limits of Limited Liability' (2007) 56 Emory Law J. 1305, 1311.

[93] M Gelter, 'The subordination of shareholder loans in bankruptcy' (2006) 26 Int'l Rev. L. & Econ 478, 500. The potential of value-enhancing shareholder loans has also been recognized by K van Zwieten, 'Related Party Transactions in Insolvency' in L Enriques and Tröger, *The Law and Finance of Related Party Transactions* (CUP 2019) 274. See also M Tucker, 'Debt Recharacterization During an Economic Trough: Trashing Historical Tests to Avoid Discouraging Insider Lending' (2010) 71:1 Ohio State Law J. 187.

[94] The Directive does not distinguish between different related parties and various possible scenarios. For instance, financing provided by creditors who have become "internal" by accepting a debt-to-equity swap, envisaged in a restructuring plan, will most likely fall under the carve out. As a result, their claims may be subordinated, while transactions involving them – challenged. Absent rescue finance protection, such creditors may be unwilling to grant support to ailing businesses or participate in debt-to-equity swaps. On this point see Stanghellini (n 5) 62.

[95] M Roe and F Tung, 'Breaking Bankruptcy Priority: How Rent-Seeking Upends the Creditors' Bargain' (2013) 99 Va. L. Rev. 1235, 1250.

insolvency (restructuring) regimes and path dependency.[96] In jurisdictions where internal creditors are treated in the same way as external creditors, the equality objection is further weakened.

Transaction avoidance and subordination rules naturally encroach on the principle of protection of trust and legitimate expectations.[97] It may be argued that shareholders and other internal creditors are certainly better equipped to calculate the risks related to financing a distressed group member. Therefore, it is difficult to claim that their legitimate expectations are breached in the event of insolvency. However, this is not always the case. When considering a complex cross-border group, different insolvency rules could potentially apply.[98] In light of the ambiguity of the European insolvency jurisdiction rules, relying on the concept of "centre of main interests",[99] the applicable *lex concursus* could remain uncertain up until the opening of insolvency proceedings. Besides, it is not only the legitimate expectations of the rescue financier that should be taken into account. External creditors of the debtor might also have reasonable expectations that intra-group support will be provided, should their direct contractual party default on its obligations. From this perspective, limitations on related party transactions may act against such expectations.

Below I introduce two scenarios characteristic for intra-group support. The first one involves financing granted by a non-distressed group member to a financially distressed member. The second concerns financial support provided by a distressed group member to another group member, also in financial distress.

4.2.1. Financial support by a non-distressed group member

In the first scenario, the recipient of funds is financially distressed, whereas the group member providing such funds, issuing a guarantee or offering collateral for the distressed entity is non-distressed. What are the risks for a lender/guarantor in a situation where the rescue attempt is unsuccessful, and the recipient enters insolvency proceedings? Depending on *lex concursus*, subordination rules may apply. For example, German law, rather indiscriminately, subordinates almost all shareholder claims. As a result, "[s]hareholder loans are usually worthless in insolvency."[100] Additionally, repayments of shareholder loans carried out within one year prior to the insolvency filing may be challenged in insolvency.[101] Insolvency administrators can also

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[96] Path dependency characterises the dependence of future (legal) developments on the previous experiences. According to Posner, "[l]aw is the most historically oriented, or […] the most backward looking, the most "past-dependent," of the professions. It venerates tradition, precedent, pedigree, ritual, custom, ancient practices, ancient texts, archaic terminology, maturity, wisdom, seniority, gerontocracy, and interpretation conceived of as a method of recovering history." See R Posner, 'Past-Dependency, Pragmatism, and Critique of History in Adjudication and Legal Scholarship' (2000) 67 U Chi L Rev 573.

[97] The use and even the existence of avoidance powers could generate legal uncertainty and discourage parties from entering into transactions. See A Gurrea-Martínez, 'The Avoidance of Pre-Bankruptcy Transactions: An Economic and Comparative Approach', III Prize submission (2017) 7.

[98] This comes from the still prevailing five one's approach, which leads to "one insolvent debtor, one estate, one insolvency proceeding, one court and one insolvency office holder" with respect to each group member. See B Wessels, S Madaus, 'Rescue of Business in Insolvency Law, Instrument of the ELI' (2017) para 697.

[99] See G McCormack, 'Jurisdictional Competition and Forum Shopping in Insolvency Proceedings' 68(1) (2009) Camb. Law J. 169, 185, arguing that "the concept of "centre of main interests" is inherently problematic and certainly capable of varying judicial interpretations." See also Horst Eidenmüller, 'Free Choice in International Company Insolvency Law in Europe' (2005) 6 EBOR 423, 430 noting that COMI as a standard is "fuzzy and manipulative, allowing forum shopping in the immediate vicinity of bankruptcy."

[100] A Spahlinger and H Kortz, 'German chapter' in G Baer and K O'Flynn (eds), *Financing company group restructurings* (OUP 2015) para 10.08.

[101] Section 135(1)(2) Insolvency Act (Germany).

challenge any security granted to the shareholder with the purpose of securing a shareholder loan, as long as security is granted within ten years prior to the request to open insolvency proceedings or subsequent to such a request.[102] In contrast, English law does not contain any impediments for granting security to a rescue financier, even if it is a shareholder.[103] It also does not prescribe subordination of shareholder loans in insolvency.

Neither Germany, nor England and Wales have special rules on rescue financing. As noted above, some other European states do have such rules. For instance, French law provides for the new money privilege (*privilège de conciliation*).[104] Creditors extending interim and new funding as part of the pre-insolvency conciliation proceedings (financing set forth in conciliation agreement or granted during the conciliation proceedings), with a view to assuring the pursuit of the business' activity and its continuity, are ranked higher than other unsecured creditors and are protected from transaction avoidance rules.[105] Besides, reorganisation plans cannot impose rescheduling of new money claims without consent of the rescue financier.[106] The new money privilege does not apply to contributions made by the shareholders of the debtor in connection with a capital increase.[107] Spanish insolvency law also recognises seniority of new funds made available to the debtor under a formal refinancing agreement.[108] However, this privilege is unavailable to persons "especially related through a capital increase operation, loans or acts for a similar purpose."[109] Intra-group financing thus risks not only being downgraded as general unsecured claims, but even subordinated to such claims.[110] To the contrary, Italian law grants certain exceptions to shareholder subordination rules in the context of financing made in view and for the purposes of *concordato preventivo* or a debt restructuring agreement.[111]

From a brief overview of different approaches to rescue financing, a few intermediate conclusions can be drawn. Firstly, recent reforms have introduced special regulation of rescue financing in several EU Member States. At the same time, the vast majority of EU jurisdictions still lack such regulation. Secondly, even regimes facilitating rescue financing may exclude intra-group financing from the protection otherwise granted to new money. Significant differences in approaches to and not infrequent ambiguity of rules on rescue financing could raise transaction costs related to cross-border group restructurings and intra-group rescue attempts. They may also facilitate insolvency forum shopping. The Directive, by introducing the protective regime for rescue financing, makes an important step towards harmonization of

[102] Section 135(1)(1) Insolvency Act (Germany).
[103] RJ de Weijs and M Baltjes, 'Opening the Door for the Opportunistic Use of Interim Financing: A Critical Assessment of the EU Draft Directive on Preventive Restructuring Frameworks' (2018) 27 Int. Insolv. Rev. 223, 242.
[104] Article L.611-11 Commercial Code (France).
[105] J-M Valentin and S Paillotin, 'French chapter' in Baer (n 100) paras 9.43-9.46.
[106] Article L 626-20 Commercial Code (France).
[107] In order to get the privilege, shareholders should "choose to make a current account advance or contribute complex transferable securities, as this will not constitute an immediate capital increase." See Wessels (n 58) 124.
[108] Section 84.2.11 Insolvency Act (Spain).
[109] Ibid.
[110] A Bou, 'Spanish chapter' in Baer (n 100) paras 21.23 and 21.26.
[111] The Italian Insolvency Code: New Rules on 'Debtor-in-Possession' Financing, Latham & Watkins Restructuring, Insolvency & Workouts Practice, April 16, 2019, No. 2485. Other jurisdictions, such as Latvia and Norway also do not seem to "disable" rescue finance privileges and protection in situations where rescue finance is provided by shareholders or other insiders. See Sec. 40(5) Insolvency Law (Latvia), Sec. 10 Rights of Priority Act (1970:979) (Sweden).

approaches to pre-insolvency transactions and rescue financing.[112] However, as noted above, the Directive allows EU Member States to disapply this regime in cases of transactions involving related parties. As a result, the existing discrepancies, inefficiencies and problems outlined in the introduction will remain.

4.2.2. Financial support by a distressed group member

The Directive mentions that "[g]reater coherence of restructuring and insolvency procedures should facilitate the restructuring of groups of companies."[113] EU Member States are encouraged to "lay down specific provisions on early warning tools for large-sized enterprises and groups, that take into account their peculiarities."[114] Unfortunately, the Directive does not go any further in clarifying how preventive restructuring frameworks should operate in a group context. Moreover, on closer scrutiny the provisions of the Directive turn out to be one-sided and take the perspective of a single company only.

The provisions on interim and new financing ensure that rescue financing is adequately protected and, as a minimum, is not declared void, voidable or unenforceable, should the insolvency follow. The question is whether this protective umbrella covers only insolvency proceedings, initiated against the debtor-receiver of rescue financing, or whether it also extends to other insolvency proceedings, for instance, those opened against the creditor-provider of rescue financing. In other words, is the protective umbrella big enough to cover two or more parties? The literal interpretation of the relevant provisions supports the narrow view, since they only mention "subsequent insolvency of the debtor" (i.e. recipient company). But what happens if at the moment of financial assistance or soon thereafter, the provider of such assistance is/becomes itself financially distressed? The Directive does not give an answer to this question. It is therefore likely that interim and new financing "approved" in the restructuring proceeding of the receiving entity is subsequently held void or unenforceable in the insolvency proceeding of the providing entity.

It is not difficult to imagine the following scenario. Group member A has some "free" cash reserves but otherwise limited pool of assets and negative short-term business projections. Group member B needs liquidity to pay back its financial creditors, otherwise risking triggering cross-defaults, affecting A. B enters the preventive restructuring framework. As part of such proceedings, and upon approval by the relevant court, A extends credit to B, thus preventing cross-defaults. Subsequently A becomes insolvent. In this case, it is conceivable that the approval granted in the restructuring proceedings of B will not bar transaction avoidance in the insolvency of A. The same applies if, instead of a loan, A provides a guarantee or collateral to secure the credit extension from a third party (e.g. a bank) to B. Should A go insolvent, this guarantee or collateral may become an easy target for an avoidance action.[115] This can negatively affect the value of such security and result in higher interest rates, or unwillingness of third parties to provide credit altogether.

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[112] On the idea of harmonisation of rules on insolvency transaction avoidance see A Keay, 'The Harmonization of Avoidance Rules in European Union Insolvencies' (2017) 66 Int'l & Comp. L.Q. 79. See also O Casasola, 'The transaction avoidance regime in the recast European insolvency regulation: Limits and prospects' (2019) 28 Int. Insolv. Rev. 163.
[113] Recital 15 Directive.
[114] Recital 22 Directive.
[115] For current approaches to avoidance of cross-guarantees in the US, Belgium and the Netherlands, see NACIIL Report, *The 800-pound gorilla. Limits to group structures and asset partitioning in insolvency* (Eleven 2019).

A number of guidelines produced by global standard-setting organisations encourage granting of financial assistance to a distressed group member by another group member, itself in distress. For example, the World Bank stipulates that the insolvency system should "permit an enterprise group member subject to insolvency proceedings to provide or facilitate post-commencement finance or other kind of financial assistance to other enterprises in the group which are also subject to insolvency proceedings."[116] Similarly, UNCITRAL accepts that insolvency law should permit an enterprise group member subject to insolvency proceedings to advance post-commencement finance or grant a security interest/provide a guarantee to another enterprise group member subject to insolvency proceedings.[117] As a result, some detriment, even if only in the short term, to the interests of an individual group member for the long term benefit of the enterprise group, could be justified.[118]

If we assume that intra-group support can be beneficial for rescuing a failing group, what should be the proper regulatory framework? In the introduction, I posed a question whether intra-group support transactions should be addressed on an entity-by-entity basis or instead considered at the group level, taking into account the economic (group) reality. Whereas the Directive does not provide answers to these questions, another recent EU instrument, be it in the context of bank insolvency, may do so.[119] The BRRD was adopted in 2014. In contrast to the Directive, intra-group financial support arrangements within the framework of bank resolution are well developed and harmonised across Europe. The goal of such arrangements is to "enable cross-border groups to allocate liquidity optimally when the group is in financial distress."[120] To the extent that both the Directive and the BRRD aim at harmonising rescue frameworks in Europe, both seek to enhance legal certainty and the removal of impediments to rescue financing, while maintaining adequate safeguards for creditors, it is reasonable to inquire whether the Directive and its future application can benefit from the BRRD's approach and whether a balance between promoting rescue and preventing abuse can be found and sustained?

5. Bank Recovery and Resolution Directive and intra-group financial support

In response to the global financial crisis, EU policymakers adopted a set of legal instruments containing measures to ensure resolution of financial institutions without severe systemic disruption or involvement of taxpayers' money. Among such instruments, the BRRD and the Single Resolution Mechanism (SRM) Regulation.[121] This article primarily discusses the BRRD as an instrument binding on all EU Member States and containing a special regime for intra-group financial support. This Section starts with the description of the principles and goals of the BRRD and the specific context of financial institutions it operates in (Section 5.1.). It then introduces a framework for intra-group financial support sanctioned by the BRRD, with special

[116] The World Bank (n 23) C16.2, 27.

[117] UNCITRAL Legislative Guide on Insolvency Law, Part III (2010), Recommendations 211-213.

[118] UNCITRAL Working Group V, Directors' obligations in the period approaching insolvency: enterprise groups, Fifty-second session, A/CN.9/WG.V/WP.153 (2017) para 8.

[119] A simple comparison of the number of references to "group" in each document is revealing. The Directive uses it 7 times, the BRRD – more than 540.

[120] EBA, Guidelines specifying the conditions for group financial support under Article 23 of Directive 2014/59/EU, EBA, 9 July 2015.

[121] Regulation (EU) No 806/2014 of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund.

attention to the purpose of the framework, the criteria and conditions for its application and the category of a "group interest" in provision of intra-group financial support (Section 5.2.).

5.1. Principles and goals of bank resolution

The BRRD was agreed in 2014 and entered into force on 1 January 2015. It represents the first major attempt to harmonise substantive rules on bank resolution across the EU/EEA.[122] Before that, financial distress in the European banking sector was addressed at the national level, inter alia, by way of general insolvency law, with possible modifications, or via specific legislation tailored to financial institutions and their specific relationships (e.g. holding accounts for account holders). This proved to be inadequate for a number of reasons. Firstly, traditional insolvency procedures turned out to be lengthy, costly and not always capable of ensuring continuation of essential functions, which prevented quick resolution of bank financial crises and contagious effects of bank failures.[123] Secondly, while the operations of cross-border banking groups were deeply interconnected across geographical lines, the powers to intervene remained national. This complicated cross-border cooperation and led to suboptimal results.[124]

In 2011, the Financial Stability Board (FSB) issued the Key Attributes of Effective Resolution Regimes (Key Attributes),[125] the internationally agreed insolvency standards for credit institutions. The Key Attributes seek to facilitate the creation of an effective resolution regime, which would "make feasible the resolution of financial institutions without severe systemic disruption and without exposing taxpayers to loss, while protecting vital economic functions."[126] Somewhat in contrast with traditional insolvency law, which aims at safeguarding creditors' rights, the Key Attributes propose that in financial distress losses should be allocated to unsecured and uninsured creditors and that departure from the general principle of equal treatment of creditors of the same class may be necessary to contain the potential systemic impact of bank failures. This new approach comes from the acceptance of a special role played by banks in the society. Banks act as intermediaries between depositors and borrowers, holding liquid liabilities in the form of deposits and long-term assets, such as mortgage loans. Because of this mismatch, banks are particularly prone to creditors' runs and exacerbated common pool problem, which can easily spill across the financial system.[127] As a result, financial stability may be at risk.

Haentjens and Wessels persuasively characterise the recent legislative developments in the area of bank resolution in terms of "three paradigm shifts".[128] The first shift concerns the rise of the public interest, at times subordinating private interests. The second shift indicates the leading role of government authorities in resolving financial distress of credit institutions. The third shift refers to the European harmonisation of a bank resolution framework, away from

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[122] Prior to the BRRD, some harmonization was facilitated by the Directive 94/19/EC of 30 May 1994 on deposit-guarantee schemes and the Directive 98/26/EC of 19 May 1998 on settlement finality in payment and securities settlement systems and CIWUD.
[123] This problem was noted before the global financial crisis, see E Hüpkes, 'Insolvency – why a special regime for banks?' (2005) 3 IMF Current Developments in Monetary and Financial Law. See also R Guynn, 'Are Bailouts Inevitable?' (2012) 29 Yale J. Regul. 121, 137 noting that "bankruptcy is a slow and deliberate process that is not designed for preserving systemically important operations critical to the functioning of the economy as a whole."
[124] Impact Assessment accompanying the document – Proposal for a Directive establishing a framework for the recovery and resolution of credit institutions and investment firms, SWD(2012) 166 final (Impact Assessment).
[125] Financial Stability Board (n 23).
[126] Ibid preamble.
[127] Michael Schillig, *Resolution and Insolvency of Banks and Financial Institutions* (OUP 2016) 63-64, explaining that vulnerability of banks resulting from holding liquid liabilities repayable on demand and illiquid assets.
[128] M Haentjens and B Wessels, 'Three Paradigm Shifts in Recent Bank Insolvency Law' (2016) 7 JIBLR 396-400.

pure domestic solutions. All three shifts are manifested in the BRRD. The prevalence of the public interest is best exemplified by the application of bail-in – one of the resolution tools that ensures that losses are absorbed by creditors, and do not consume public resources.[129] The determination of the public interest is closely tied to the powers granted to public (resolution) authorities in the context of bank resolution. The BRRD has effectively introduced an administrative procedure with limited court involvement and significantly curtailed powers of actors involved, i.e. creditors, debtors, shareholders.

It is clear that regulation of bank resolution is very different from ordinary corporate insolvency law. This inevitably raises a question of the applicability of the insolvency law principles, introduced above, to bank resolution. Should the answer be negative, any further discussion of the mechanisms found in the BRRD and dealing with intra-group financial support, and their relevance for non-financial corporate groups, may be without sound theoretical basis. Schillig argues that the relevance of insolvency law is in supplementing the otherwise incomplete frameworks of the BRRD and the SRM.[130] National insolvency law is fully applicable to restructuring or liquidation of banks, whose resolution is not considered to be in the public interest. Janssen classifies bank resolution law as a special part of insolvency law, with its underlying principles applicable to bank resolution.[131]

The principles of the BRRD are summarised in Article 34. Among them, treatment of creditors in the same class in an equitable manner,[132] no-creditor-worse-off (NCWO) principle,[133] ranking of creditors' claims in accordance with normal insolvency proceedings.[134] The BRRD also mentions that while the need to act rapidly may justify derogations from mandatory rules for the protection of shareholders and creditors, such derogations should be clearly and narrowly defined in order to ensure the maximum degree of *legal certainty* for stakeholders.[135] These principles correspond to those of general corporate insolvency law, namely equal treatment of creditors and protection of trust; even though one has to accept a number of deviations from the strict adherence to such principles, where this is in the public interest and proportionate to the risks being addressed.[136]

The most problematic and seemingly discordant principle is the principle of optimal realization of the debtor's assets. Haentjens argues that "bank resolution rules should not be directed at the maximization of a bank's liquidation value […], but rather at the preservation of crucial functions, at the preservation of financial stability […]."[137] Nevertheless, the fact that the

[129] Articles 43-55 BRRD. Considering how the BRRD targets certain categories of stakeholders (referred to as "sacrificial lambs"), De Gioia Carabellese and Zhang categorise bail-in as "*sui generis* instrument of an administrative nature", far from falling under the insolvency law ambit. See P De Gioia Carabellese and D Zhang, 'Bail-in Tool and Bank Insolvency: Theoretical and Empirical Discourses around a New Legal (or Illegal) Concept' (2019) 30(3) Eur. Bus. Law Rev. 487, 506.
[130] Schillig (n 127) 9.
[131] L Janssen, 'Bail-in from an Insolvency Law Perspective' (2017) 26(5) Norton Journal of Bankruptcy Law and Practice, at 3. See also Sven Schelo, *Bank Recovery and Resolution* (Kluwer Law International 2015) 79, supporting this view.
[132] Article 34(1)(f) BRRD.
[133] Article 34(1)(g) BRRD. See also Recital 5 BRRD. This principle entails that in case of resolution "no creditor or shareholder shall incur greater losses than they would have incurred if the institution had been wound up under normal insolvency proceedings." See EBA Single Rulebook Q&A, Question 2015_2458. Importantly, the Directive also contains the same principle, but calls it "best-interest-of-creditors test."
[134] Article 34(1)(b) BRRD.
[135] Recital 120 BRRD.
[136] Recital 13 BRRD.
[137] M Haentjens, 'National Insolvency Law in International Bank Insolvencies' in B Santen and D van Offeren (eds), *Perspectives on international insolvency law: A tribute to Bob Wessels* (Kluwer 2014) 70.

primary goal of bank resolution is not asset value maximization does not altogether disable the principle of safeguarding the value of the debtor's business. One of the major differences from the general insolvency law approach is that such a value is preserved not for its own sake or for the sake of creditors holding bail-in-able debt, but for certain critical stakeholders (e.g. depositors) and financial stability as a whole. In other words, the recipients of the value may be different.[138] Besides, the BRRD encourages maximization of the sale price for the shares or other instruments of ownership, assets, rights or liabilities involved in the sale of business and asset separation tools.[139]

In addition to the principles, what also aligns the Directive and the BRRD is the acceptance that early reaction to financial distress (crisis prevention) is needed to preserve the viable business and avoid piecemeal liquidation. For instance, the Directive mandates Member States to incorporate early warning tools that could signal or give rise to a likelihood of insolvency.[140] The BRRD extends its regulatory framework to an even earlier time period, when a bank or a banking group is solvent and no signs of financial distress are in sight. This concerns recovery and resolution planning. Under the BRRD, banks and banking groups must draw up and maintain recovery plans (also known as "living wills") containing measures to restore financial soundness in case of an imminent crisis.[141] Resolution authorities make advance preparations by drawing up resolution plans, containing resolution actions.[142] Thus, both the Directive and the BRRD promote early measures to stop the downward spiral of financial distress. The latter does it by administrative means and with the help of resolution authorities, the former primarily relies on the debtor and its management.

To sum up, bank resolution has its specificity, dictated by the volatility of liabilities held by credit institutions and the importance of critical functions and services provided by banks for financial and social stability. Nevertheless, legal principles underlying regulation of bank insolvency, as well as the policy objective of early crisis prevention bridge the gap between bank resolution and general corporate insolvency law. This finding opens the door for further analysis of the BRRD's framework for group financial support arrangements.

5.2. Intra-group financial support under the BRRD

The global financial crisis has revealed that banks frequently operate as an integrated global enterprise. However, in legal terms, this economic and operational reality is backed by complex and highly fragmented corporate structures, partially caused by regulatory and tax distortions.[143] Due to the high degree of interconnectedness, several problems may appear. The first one relates to the cash management system within banking groups.[144] A good

[138] In the dichotomy introduced by Dworkin, the principle remains untouched, while the policy goal is changed. See also RJ de Weijs, 'Too Big to Fail as a Game of Chicken with the State: What Insolvency Law Theory Has to Say About TBTF and Vice Versa' (2012) 14 EBOR 201, 216, arguing that as far as the liquidation measures are concerned, the new interests never really trump the interests of creditors – the latter are guaranteed by the operation of the NCWO principle.
[139] Recital 61, Article 39, Article 42 BRRD.
[140] Article 3 Directive.
[141] Articles 5 and 7 BRRD.
[142] Articles 10, 12 BRRD.
[143] R Herring and J Carmassi, 'The Corporate Structure of International Financial Conglomerates: Complexity and its Implications for Safety and Soundness' in A Berger, P Molyneux, and J Wilson (eds), *The Oxford Handbook on Banking* (1st edn, OUP 2012) 197.
[144] A survey conducted by the Joint Forum Working Group on Risk Assessment and Capital has revealed that the majority of the financial institutions surveyed used centralised capital and liquidity management systems, which

example is Lehman Brothers, where the US holding company, Lehman Brothers Holdings Inc. (LBHI), acted as the banker for the hundreds of its affiliates. According to the report, prepared by an examiner in the Chapter 11 proceedings of LBHI (also referred to as "Valukas Report"), LBHI controlled "the cash disbursements and receivables for itself, its subsidiaries and its affiliates."[145] This was done to track all cash activities, maximise investment opportunities and minimise transaction costs. The holding company lent money to its operating affiliates "at the beginning of each day and then swept the cash back to LBHI at the end of each day."[146] When LBHI filed for insolvency in the US on 15 September 2008, most of the group funds became part of the US proceedings, and therefore – as was generally held – unavailable for supporting its subsidiaries.[147] The results were often disastrous for such subsidiaries, and their creditors.

Intra-group financing between banking group members is "large, volatile, and heavily relied upon around the world."[148] At the same time, financial distress may disentangle the free flow of capital within banking groups, impacting the financial soundness of the group and its constituent members. Here comes the second problem, the entity-by-entity treatment of banking group members and the policy of ring-fencing such group members (and their assets) from the rest of the group. This could be dictated by the desire to prevent undue influence by a foreign entity or a foreign government, to stop outflow of funds and protect local interests (i.e. local depositors and other creditors).[149] During the financial crisis, many jurisdictions tightened restrictions on intra-group cross-border financial transfers, limiting the ability of banking groups to optimally allocate liquidity.[150] As a result, ring-fencing increased the chances of further defaults (cross-defaults) and complicated the realisation of group recovery plans. Besides, banks are generally not immune from transaction avoidance rules discussed above, which allow intra-group transfers to be retroactively ruled void or ineffective.

In the aftermath of the global financial crisis, the Basel Committee on Banking Supervision (BCBS) suggested that greater convergence of national laws or a comprehensive framework were needed to effectively resolve international financial groups.[151] Among areas deserving harmonisation, the BCBS mentioned national rules governing the treatment of intra-group claims. Such harmonisation has partially been achieved by the BRRD through the establishment of a special regime for intra-group financial support. The following Sections describe the purpose of this innovative regime, its main characteristics, advantages and disadvantages.

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allowed for the efficient management of the group capital, helped maximise liquidity and reduce cost of funds. See BCBS, Report on intra-group support measures (2012) 6.

[145] Lehman Brothers Holdings Inc. Chapter 11 Proceedings Examiner's Report (Valukas Report) (2010) 1550.

[146] Herring (n 143) 225.

[147] Emilios Avgouleas, *Governance of Global Financial Markets. The Law, the Economics, the Politics* (CUP 2012) 254.

[148] D Reinhardt and S Riddiough, 'The Two Faces of Cross-Border Banking Flows' (2014) 498 Bank of England Working Paper 25.

[149] E Cerutti et al. 'Bankers Without Borders? Implications of Ring-Fencing for European Cross-Border Banks' (2010) WP/10/247 IMF Working Paper 4. See also BIS (n 36) 16, describing how the global financial crisis has illustrated that national interests (i.e. protection of local shareholders, depositors, taxpayers) had played the leading role in decision-making.

[150] See EC, Final Report, Study on the feasibility of reducing obstacles to the transfer of assets within a cross border banking group during a financial crisis (2010).

[151] BIS (n 36) 21.

5.2.1. Purpose of the BRRD regime for intra-group financial support

Prior to the BRRD, there was no EU-wide framework, addressing provision of rescue financing within banking groups. This discouraged group members from making arrangements to help each other, even if such help was economically justified.[152] To address this issue the European Commission considered a number of alternatives, from no policy change (baseline scenario) to the introduction of the concept of "group interest" and voluntary group financial support agreements. It was recognised that the adoption of the all-pervading principle of "group interest" could undermine the company law principle of legal separability. However, the establishment of an early financial mechanism in the form of a voluntary agreement (also referred to as "pre-emptive transaction") to stop the aggravation of financial troubles inside the group, was supported.[153] It was argued that such a mechanism would alleviate concerns regarding directors' liability, minimise risks of transaction avoidance and increase clarity for creditors.

The BRRD recognises that granting financial support by one entity of a cross-border banking group to another group entity may be restricted by provisions of national laws designed to protect the interests of creditors and shareholders of each entity.[154] In order to overcome such restrictions, the BRRD has introduced a special regulatory regime called "group financial support agreement". The purpose of such a regime is to ensure financial stability of banking groups without jeopardising liquidity or solvency of providing (supporting) entities. In line with evidence on the effectiveness of rescue financing (see Section 3.2.), there is empirical and theoretical support confirming the beneficial role of intra-group financing during the global financial crisis.[155]

5.2.2. Main characteristics of group financial support agreements

This Section provides an overview of the major characteristics of group financial support agreements. Transactions falling under the protective regime of such agreements should be safeguarded from any legal impediments in national law,[156] such as transaction avoidance rules.[157]

Firstly, intra-group support may take difference forms, including provision of a loan, a guarantee, assets to be used as collateral, or any combination of those forms of financial

[152] The level of concentration and consolidation of the banking sector in Europe remains relatively high. Centralization creates group synergies and allows for better (cost-saving) allocation of resources within the group. It is also achieved through integrated IT, personnel and property management. This is why the consequences of inhibiting intra-group transfers may be significant. For the market overview, see ECB, Report on financial structures, (2017) <https://www.ecb.europa.eu/pub/pdf/other/reportonfinancialstructures201710.en.pdf> accessed 8 February 2020.

[153] Impact Assessment (n 124).

[154] Recital 38 BRRD.

[155] G Navaretti, G Calzolari, A Pozzolo, M Levi, G Ottaviano and D Marin, 'Multinational banking in Europe – financial stability and regulatory implications: lessons from the financial crisis' (2010) 25(64) Economic Policy 703, 706 noting that multinational banks "have kept being a substantial and stable source of financial resources for host economies."

[156] Article 19(4) BRRD.

[157] In my opinion, subordination rules, found in some national insolvency laws, may also be treated as "legal impediments" in the meaning of Article 19(4) BRRD. For example, the implementation of the BRRD in Italy prescribed both the disapplication of the general related party transaction rules and the provisions on equitable subordination of shareholders' loans. See F Sbarbaro, 'The Italian Regulation of the Intra-Group Financial Support Agreement in a Comparative Perspective' (2018) 9(1) Upravlenets 24, 29.

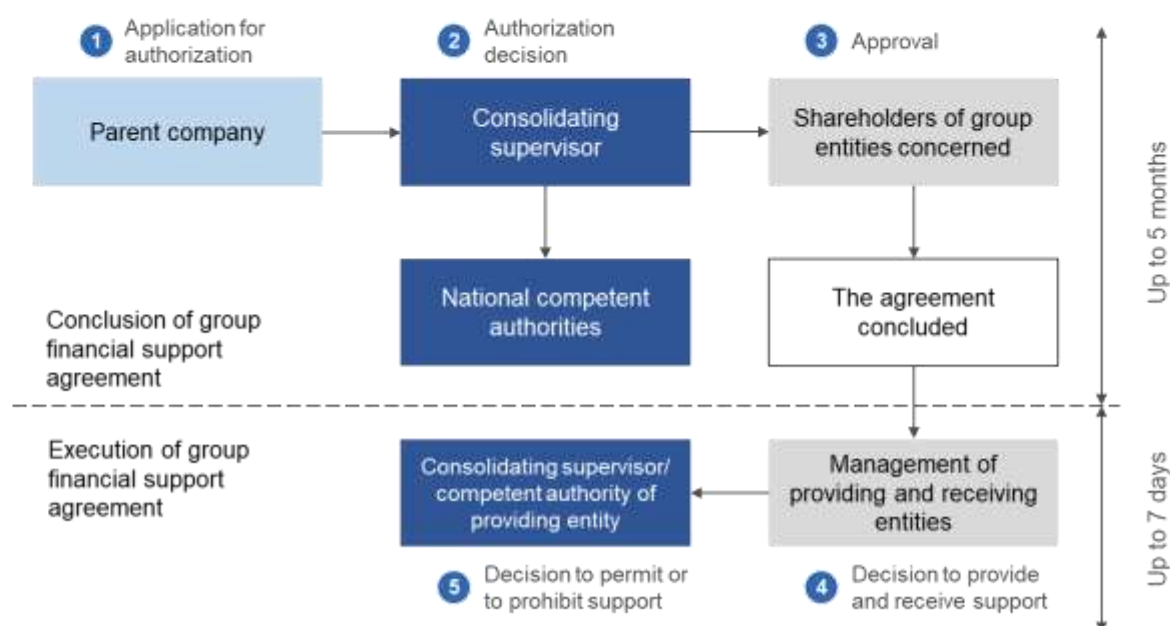
support.[158] It can cover one or more entities in the group and involve support from the parent undertaking to subsidiaries (downstream), from subsidiaries to the parent undertaking (upstream) and between subsidiaries of the same group (cross-stream), or a combination of these variations.[159]

Secondly, the issue of timing should be highlighted. The EC called a group support agreement a “pre-emptive transaction”, highlighting that such a transaction is entered pre-emptively and does not entail an immediate transfer of funds. It is rather a commitment or a promise to provide support, should the conditions for it be satisfied. This is why a group financial support agreement may only be concluded if none of the parties meets the conditions for an early intervention.[160] While the agreement itself needs to be concluded before there are any signs justifying early intervention, the actual support must be carried out in early intervention scenarios. “Business-as-usual” transactions and transactions in all other scenarios outside early intervention, do not fall within the scope of Chapter III BRRD.[161]

Thirdly, the procedure for concluding and executing intra-group financial support agreements is rather complicated.[162] First, the parent company must submit an application for the authorization of the agreement to the consolidating supervisor.[163] This application is then transmitted to competent authorities of each entity involved in the agreement, with a view to reaching a joint decision. If no decision is reached within four months, the consolidating supervisor shall make its own decision on the application. The matter can also be referred to the European Banking Authority (EBA), an independent EU regulatory agency. In that case it is the EBA that makes the final decision binding on the group level supervisor. Following the authorization, the agreement needs to be approved by shareholders of every group entity involved in the agreement. Only with such an approval the agreement can be considered validly concluded. The whole procedure may take up to five months or longer, and this is not even the end of the story. While the actual decision to provide financial support (i.e. to execute the group support agreement) must be taken by the management body of the group entity providing financial support, the competent authority of that group entity is empowered to prohibit or restrict it. Should the consolidating supervisor or the competent authority of the receiving entity disagree with this prohibition or restriction, they can request assistance from the EBA. However, unlike at the agreement approval stage, at the authorisation stage the EBA has only non-binding mediation powers.

[158] Article 19(5)(b) BRRD. Notably, this expansive attitude to group financial support matches the scope of rescue financing, as adopted under the Directive.
[159] Article 19(5)(a) BRRD. None of the parties should be likely to breach any capital or liquidity requirements.
[160] Article 19(8) BRRD. Triggers for early intervention measures include infringement or likely infringement of Regulation (EU) No 575/2013 or Directive 2013/36/EU, addressing prudential requirements for credit institutions. See also EBA, Final Report, Guidelines on triggers for use of early intervention measures pursuant to Article 27(4) of Directive 2014/59/EU, 8 May 2015.
[161] Single Rulebook Q&A, Question ID 2016_2581.
[162] The procedure is described in Articles 20-25 BRRD. For the summary of the approval processes see The World Bank, ‘Understanding Bank Recovery and Resolution in the EU: A Guidebook to the BRRD’ (2017) 56-61.
[163] The consolidating supervisor is the lead supervisor in the group oversight context. Within the euro area the ECB plays the role of a consolidating supervisor.

Figure 1. Approval and authorization of intra-group financial support



Fourthly, financial support may only be provided if special conditions, listed in Article 23 BRRD, are satisfied. For instance, there should be a reasonable prospect that the support significantly redresses financial difficulties of the group entity receiving such support (receiving entity)[164] and that the rescue financing is reimbursed in the future.[165] The EBA has published detailed guidelines specifying the conditions for group financial support.[166] These guidelines seek to facilitate restoration of financial stability of the group as a whole and prescribe a number of safeguards to protect stakeholders' interests.

Of particular importance is the concept of "group interest". This is an innovation of the BRRD, which goes beyond a single-entity vision adopted in the Directive. Under the BRRD, when approving the agreement and the actual provision of financial support, competent authorities should analyse and compare the direct and indirect benefits for the group as a whole, which may result from rescuing an ailing group member. They should consider the potential risks for the group and the providing entity, created by the default and insolvency of the receiving entity. The group interest is also relevant for calculating the direct and indirect benefits of the entity extending financial support and resulting from the restoration of financial soundness of the receiving entity (i.e. group interest furthers entity interest). The EBA accepts that such benefits might be difficult to quantify, for instance, when it comes to saving the reputation of the group. In any event, the group interest cannot trump individual entity's interest (i.e. group interest contradicts entity interest). This is why under the BRRD, liquidity and solvency of the providing entity should not be compromised as a result of granting rescue financing.[167]

Non-compliance with prudential requirements for capital, liquidity and large exposures may be authorised in very exceptional circumstances.[168] When authorising such an exception, the

[164] Article 23(1)(a) BRRD.
[165] Article 23(1)(d) BRRD.
[166] EBA (n 120).
[167] Article 23(1)(e) BRRD.
[168] Article 23(1)(g) BRRD.

competent authority should consider the significance of the capital shortfall (liquidity shortage), the expected timeframe to restore compliance with prudential requirements, the best interests of the providing entity (including indirect benefits from group stabilization), and the risks and benefits for financial stability.[169] For upstream and cross-stream support, it should specifically analyse whether the support is necessary to prevent the failure of the receiving entity, the likelihood and the effects of the destabilization of the group as a whole resulting from this failure.

5.2.3. Pros and cons of the BRRD group financial support framework

The effectiveness of the BRRD regime for group financial support agreements is difficult to assess, since its utility has not yet been tested. Unlike group recovery plans, which remain confidential and unavailable to the public, the BRRD contains the duty to disclose the existence and general terms of group financial support agreements.[170] This duty serves the principle of protecting trust and legitimate expectations of contracting parties (depositors, creditors, non-participating group members).[171]

One of the major achievements of the BRRD, when compared with the Directive, is the acknowledgement that financial distress frequently affects companies that are part of larger integrated enterprises. This is evident in the EU regulation, specifying the content of recovery plans.[172] For example, it clarifies that such plans should be integrated in the overall corporate governance of the institution or the group.[173] The description of enterprise group members shall contain both the general characterization of the entities covered by the recovery plan and a detailed description of the group legal and financial structures, including intra-group exposures and funding relationships, such as intra-group guarantees, group financial support agreements and profit and loss transfer agreements.[174] Thus, recovery plans reveal corporate, operational and legal interconnectedness of banking groups.

Instead of treating companies atomistically, on an entity-by-entity basis, the BRRD proposes a tool for realising the group interest and ensuring financial stability of the group as a whole. In this respect, a clear and transparent framework for intra-group financial support should contribute to the optimal allocation of resources within the group and facilitate estate value maximization. In addition, ex ante preparation of group recovery plans and conclusion of pre-emptive financial support agreements can play an educational and disciplining role, creating awareness of possible (operational, financial, legal) risks and problems.[175] The process of drafting and approving group support agreements, and placing them within the structure of a

[169] EBA (n 120) 12-16.
[170] Article 26 BRRD.
[171] In the USA bank resolution plans consist of two parts: a private (confidential) section hidden from the public and a public section, available via the website of the Federal Deposit Insurance Corporation (FDIC). A brief review of a number of resolution plans, submitted with the FDIC, has revealed that banks do enter into contractually binding mechanisms, authorising intra-group support in crisis situations. See e.g. Citigroup Inc. 2017 Resolution Plan, Public Section (2017); JPMorgan Chace & Co. Resolution Plan Public Filing (2017).
[172] Commission Delegated Regulation (EU) 2016/1075 of 23 March 2016 with regard to regulatory technical standards specifying the content of recovery plans, resolution plans and group resolution plans.
[173] See EBA, Guidelines on the minimum list of qualitative and quantitative recovery plan indicators, Final report, 6 May 2015.
[174] Commission Delegated Regulation (EU) 2016/1075, Article 7. See also EBA, Recommendation on the coverage of entities in a group recovery plan, Final report, 1 November 2017.
[175] M Ventoruzzo and G Sanderelli, 'O Tell Me the Truth About Bail-In: Theory and Practice' (2019) 442/2019 ECGI Working Paper Series in Law 20.

group of companies could also help address the pertinent problem of the lack of transparency and ignorance of corporate form.[176]

Nevertheless, significant limitations of the BRRD's framework should be highlighted. Firstly, the procedure for concluding and executing group support agreements is complex, time-consuming and multi-level/multi-actor. Rescue financing is frequently needed on an urgent basis, where the financial situation of a group is rapidly deteriorating. Going through the authorization process for extending support may take a week or longer, thus hampering the utility and practical relevance of the group support mechanism.[177] Besides, a competent authority can at any time prohibit or restrict the actual granting of support. Secondly, the fact that the agreement has to be concluded long before the actual execution, could make it less suitable for a particular crisis situation. For this reason, Babis argues in favour of entering into group support agreements at a later stage, when the incentives for support might be stronger.[178] Thirdly, generally the BRRD allows transfer of funds only if the providing entity is not insolvent and fully complies with prudential requirements. This may significantly restrict financial support when the whole group is in distress, which could happen in times of an economic downturn and financial instability. In principle, the BRRD leaves open the window for rescue financing by a distressed (though, not insolvent) banking group member. However, this window is rather small and is premised on the considerations of the best interest of the providing entity and risks arising from destabilization of the group as a whole.

6. Between creditor protection and group interest

The previous Sections described the general approach to interim and new financing proposed by the Directive and the position of the BRRD on group financial support agreements. While some authors believe that the protection granted by the Directive to rescue financiers goes too far and at the expense of the existing creditors,[179] I have shown that the Directive does not go far enough to consider the group context and the provision of rescue financing by corporate group members.

It is true that internal creditors are different from external or non-related creditors. As set out in Section 4.1., the former have better access to debtor's financial documents, can oftentimes influence debtor's decision-making and therefore could easier calculate investment risks. Equally important is the danger that internal creditors may act opportunistically and transfer assets out of other creditors' reach in the vicinity of insolvency (asset stripping)[180] or seek to improve their position in anticipation of insolvency. These are all valid concerns that underpin modern rules on related party transaction avoidance and subordination of shareholder loans.

[176] This problem has been insightfully described by Jay Westbrook, who called the structure of modern corporate group "the engine of injustice and fraud" and argued for "the observance of the corporate form throughout the life of the corporation." See J Westbrook, 'Transparency in Corporate Groups' (2018) 13 Brook. J. Corp. Fin. & Com. L. 33, 34.

[177] Schillig (n 127) 191, noting that the process for approving group financial support agreements and granting actual support are "unsuitable to adequately address a crisis situation."

[178] V Babis, 'EU Recovery and Resolution Framework: Financial Assistance Between Banking Group Members' (2012) 15/2012 University of Cambridge Legal Studies Research Paper Series 14.

[179] Payne (n 59); De Weijs (n 103).

[180] This strategy was realised in the case of the American casino-entertainment company Caesars Entertainment Operating Co., which involved the shifting of assets from one company to its affiliates. See Final Report of the Examiner R Davis, *In re Caesars Entertainment Operating Co, Inc* (Bankr. E.D. Ill.), 2016.

However, as argued above, it is difficult to reconcile this rigid approach with the major principles of insolvency law.

A delicate balance should instead be sought to protect creditors of both the entity providing rescue financing and the receiving entity, and simultaneously maintain or even increase the going concern value of the group as a whole. Below I propose a number of mechanisms that could potentially serve to reduce the risk of group opportunism and address the scenarios discussed in Section 4.2.

6.1. Financial support by a non-distressed group member

Section 3.3. highlighted the differences between interim and new financing. While the former secures business continuation for the duration of a preventive restructuring proceeding, the latter ensures the implementation of a restructuring plan. Distinct purpose and nature of these two types of financial support warrant their separate treatment.

If interim financing is granted by a solvent group member, whose financial position does not adversely change due to a credit extension or provision of a guarantee or collateral, little can be said against the application of the general protective framework to intra-group rescue financing. There is no reason to declare it void, voidable or unenforceable and its grantors should not incur civil, administrative or criminal liability solely on the ground that it is provided by an internal creditor. Considering the urgency of interim financing and the fact that its amount is usually not very large (i.e. amount necessary to continue debtor's business as usual), the involvement of a court, an IP or a restructuring expert,[181] does not seem to be generally justified.[182] Nevertheless, if the amount of interim financing is substantial (compared to the total value of the debtor's (unencumbered) assets) or such financing can significantly affect the rights of creditors of the receiving entity, the requirement for the ex ante control or approval may be considered.

The *pari passu* principle is at stake, should the interim financier be accorded a privileged position in insolvency (e.g. if rescue financing is secured). In this case ex ante control, envisaged in the Directive[183] is necessary. Despite additional hurdles that such control creates, the need to protect creditors and minimise the risk of opportunistic behaviour by insiders makes it proportionate. In any event, the approval of the court or a restructuring expert should be granted only when interim financing serves the interests of the general body of creditors and does not materially prejudice the interests of any individual creditor or a group of creditors. This decision needs to be taken expeditiously. Procedural obstacles analogous to those found in the BRRD could make the whole approval process unworkable in practice.[184]

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[181] The Directive introduces a special actor called a "practitioner in the field of restructuring" (restructuring expert). The main tasks of such an expert include assisting the debtor or the creditors in drafting or negotiating a restructuring plan, supervising the activity of the debtor during the negotiations on a restructuring plan and taking partial control over the assets or affairs of the debtor during negotiations. See Article 2(12) Directive.

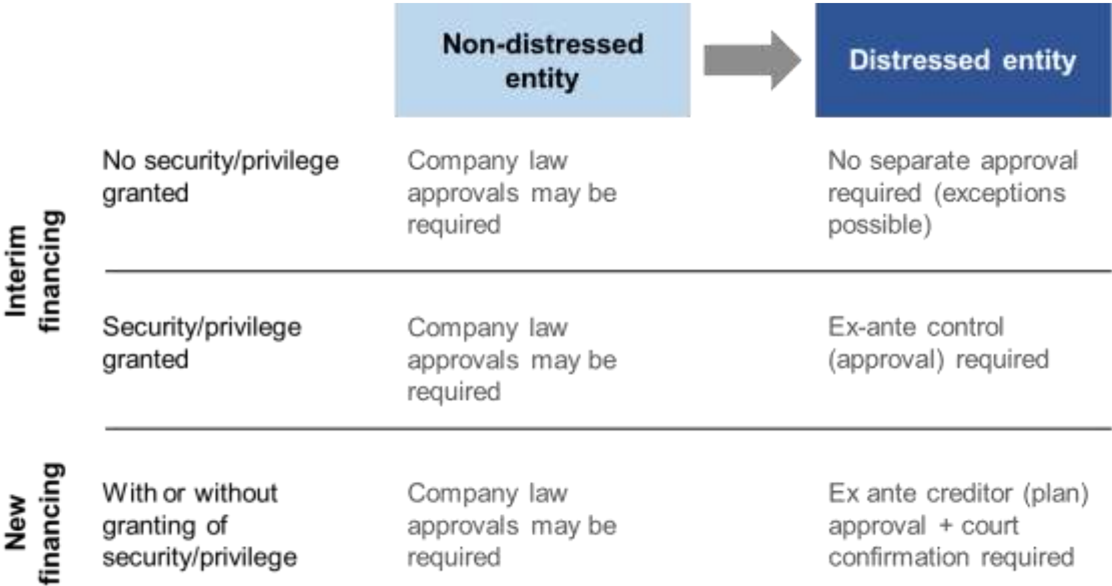
[182] A different opinion is advanced by Wessels and Madaus, who argue that any decision to accept interim financing "is a decision about causing additional administrative expenses for the estate" and is therefore "relevant for the payoff to all unsecured creditors." As a result, they suggest the involvement of an insolvency practitioner or/and the approval by a court. See Wessels (n 98) para 341. The same approach is embraced in Article 42(a) Dutch bill for the Act on the confirmation of private plans (commonly referred to as "WHOA").

[183] Article 17(2) Directive.

[184] In this respect, the court can make an interim order, approving a portion of requested financing, urgently needed to keep the debtor's business afloat. This would give time for a more thorough consideration. A similar approach is

When it comes to new financing, being a part of a restructuring plan, an approval by creditors and a court confirmation are advisable irrespective of the granting of priority. This is justified by the fact that new financing usually involves larger amounts of funds, is less urgent compared to interim financing, has a larger time span and comes at a time, when creditors have better understanding of the debtor's financial situation and recovery prospects. Hence, creditors can make a decision on an informed basis and in a timely manner.[185] Understandably, this could create additional complexity and delays, leading to inefficiencies and increased transaction costs. But these disadvantages are clearly outweighed by the benefits of additional scrutiny and add-on protection of interests and rights of the affected parties (i.e. unsecured creditors, employees). After all, if the rescue attempt fails, it is creditors who bear the risks of insolvency. This is why it is reasonable to let them decide on the contents of a restructuring plan, including the acceptance or refusal of new financing.

Figure 2. Interim and new financing by a non-distressed group member



		Non-distressed entity	Distressed entity
Interim financing	No security/privilege granted	Company law approvals may be required	No separate approval required (exceptions possible)
	Security/privilege granted	Company law approvals may be required	Ex-ante control (approval) required
New financing	With or without granting of security/privilege	Company law approvals may be required	Ex ante creditor (plan) approval + court confirmation required

6.2. Financial support by a distressed group member

Unlike the Directive, which overlooks the group context, the BRRD embraces the existence of a group and the concept of a group interest, although to a limited extent.[186] This concept plays a special role in the scenario where both the debtor and a rescue financier are financially distressed and may ultimately become insolvent. It is worth noticing that discussions about the recognition of the group interest in European company law have taken place since the 1990s,

adopted in DIP financing practice, see Mark Roe, Frederick Tung, *Bankruptcy and Corporate Reorganization, Legal and Financial Materials* (4th edn, Foundation Press 2016) 412.

[185] As convincingly stated by Justice Hildyard in the case involving confirmation of the scheme of arrangement for the Apcoa group, the "Court's role is not to substitute its own assessment of what is reasonable for that of the creditors. They are much better judges of what is in the commercial interests of the class they represent than the court." *Re Apcoa Parking Holdings GmbH* [2014] EWHC 3849 (Ch), para 128.

[186] The category of a group interest is evident in the provisions on group financial support arrangements. However, no overarching conception of a group interest may be inferred. E Ferran, LC Ho, *Principles of Corporate Finance Law* (2nd edn, OUP 2014) 41.

first among academics[187] and then under the EC Consultation on the Future of European Company Law, which was launched in 2012. The latter resulted in Company Law Action Plan, which included an initiative to recognise the concept of "group interest".[188] Despite the generally positive attitude of scholars and business community,[189] these initiatives have not resulted in any legislative proposals. This is why the example of the BRRD remains unique.

Based on this example, EU Member States may individually adopt an approach, which would permit granting of financial support (whether in the form of interim or new financing, with or without priority) to a group member, experiencing financial problems, including in a situation where the providing entity is itself distressed or becomes distressed as a result of granting group financial support. Since extending such support could harm the interests of its creditors, ex ante control in the jurisdiction of the providing entity should be required.[190] The involvement of a court and/or a restructuring expert in the jurisdiction of the receiving entity might also be necessary for determining the group interest and the position of that entity's creditors. Focusing on one entity only may not capture the overall picture. As a result, the group financial support needs to be confirmed in two parallel proceedings. This ex ante approval process should guarantee legal certainty, prevent protracted ex post litigation and avert asset stripping and gambling for resurrection. No less important is the fact that transparency of such an approval reduces information costs and signals to the market the willingness of group members to support each other.

Figure 3. Group financial support between distressed group members

Considering this double-approval procedure, two comments are due.

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[187] A group of scholars, Forum Europaeum Corporate Group Law, has recommended the introduction of a modified *Rozenblum* doctrine at the European level. See Corporate Group Law for Europe (2000) 1 EBOR 165-264. See also 'Report of the High-Level Group of Company Law Experts on Model Regulatory Framework for Company Law in Europe' ("Winter report") (2002).

[188] EC, 'Action Plan: European company law and corporate governance - a modern legal framework for more engaged shareholders and sustainable companies' (2012) COM/2012/0740 final.

[189] P-H Conac, 'Director's Duties in Groups of Companies – Legalizing the Interest of the Group at the European Level' (2013) 10(2) ECFR 195-226; M Winner, 'Group Interest in European Company Law: an Overview' (2016) 5(1) Acta Universitatis Sapientiae: Legal Studies 85-96.

[190] In the BRRD framework, this role is played by competent authorities. Note that in many EU jurisdiction there is currently no procedures for ex ante approval of rescue financing. The ex post control of pre- and post-insolvency transactions is still by and large the prevailing approach.

First, group financial distress and its resolution justify a more active court and a restructuring expert, compared to a single entity rescue.[191] The group context multiplies coordination problems, thus making it more difficult for creditors of different entities to see the whole picture and adopt the most effective solution that is not narrow minded. The success of the group restructuring therefore depends on the efficiency of court-to-court communication and cooperation, both in the domestic and cross-border settings. Whenever approving group financial support, courts and restructuring experts in the jurisdictions of both the providing and receiving entities should be involved. Fortunately, court-to-court communication and cooperation is already prescribed by the EIR Recast.[192] Assuming the application of the EIR Recast to preventive restructuring frameworks,[193] no additional obligations would need to be imposed. Next to the provisions of the EIR Recast, communication and cooperation between courts is supported by various soft law guidelines.[194]

Second, the criteria for approving financial support would have to be defined. Again, the BRRD is a good example to follow. A menu of relevant criteria for the balancing of risks and benefits involved in rescue financing can be proposed. When approving group support, it is first necessary to consider the interests of the providing entity and its creditors. The following questions may be asked:

1) Can the debtor obtain the necessary financing on the market (i.e. from non-related parties) and, if so, on which terms?
2) What are the risks of default and reasonable prospects for rescue debt to be repaid?
3) How significant are the negative consequences of extending financing for the providing entity in short and medium terms?
4) Are any specific categories of creditors materially prejudiced as a result of group financial support?

When determining the interest of the providing entity, the group context and the group interest must also be considered. This will necessarily broaden the concept of a single-entity interest to include the following considerations:

5) What are the reasonable prospects that the support will significantly redress financial difficulties of the receiving entity?
6) What are direct and indirect benefits for the providing entity from the restoration of the financial soundness of the receiving entity and the group as a whole?
7) What are the risks of failure of the receiving entity and the group, and the likely consequences (adverse effects) on the financial stability of the providing entity from the destabilization of the group?

[191] In addition to courts, both the EIR Recast and the MLG introduce a special person, who should facilitate group restructuring. The EIR Recast calls such a person “group coordinator” and the MLG – “group representative.”
[192] Article 57 EIR Recast.
[193] D Zhang, ‘Preventive Restructuring Frameworks: A Possible Solution for Financially Distressed Multinational Corporate Groups’ (2019) 20(2) EBOR 285, 305 arguing that “it seems safe to reason that the newly devised national preventive restructuring procedures should all fit into the scope of EIR recast.”
[194] Among such guidelines, EU JudgeCo Principles and Guidelines (2014); UNCITRAL Practical Guide on Cross-Border Insolvency Cooperation (2009); Judicial Insolvency Network (JIN) Guidelines (2016); JIN Modalities of Court-to-Court Communication (2019).

7. Protection of rescue financing and third country perspective

How will the regime for rescue financing apply in the context of an enterprise group with group members within and outside the EU area? Arguably, in truly large corporate groups, there will nearly always be group entities established in non-EU jurisdictions.[195] At the same time, the regime for protection of rescue financing is limited by the Directive's territorial scope, i.e. EU/EEA. This limitation could significantly impede its effectiveness.

Major differences remain in substantive insolvency law, even more so outside the EU. As a result, when a providing or a receiving group entity is located in a non-EU country, a situation of legal uncertainty may arise. Recent years have witnessed serious attempts to address the issue of enterprise groups insolvencies on a global level. The most recent development is the adoption of the MLG. The purpose of this model law is to "equip states with modern legislation addressing domestic and cross-border insolvency of enterprise groups."[196] This is envisaged through the creation of tools to improve communication and cooperation between courts and to achieve a coordinated group insolvency solution.[197] Such a solution can be reached with the help of the so called "planning proceedings" and special categories of relief prescribed by the MLG. The main idea is to protect, preserve, realize or enhance the value of insolvency estates of group members and the ongoing operations of the group as a whole.

The concept of "planning proceeding" is similar to "group coordination proceeding", introduced by the EIR Recast. Both instruments seek to facilitate better coordination of insolvency (restructuring) proceedings commenced with respect to enterprise group members. Both entail voluntary participation and easy opt in or opt out. Both prescribe the appointment of a special person, referred to as "group coordinator"[198] in the EIR Recast and "group representative"[199] in the MLG.

Among the relief available to a planning proceeding, the MLG mentions approval of arrangements concerning funding of a group member and authorization of the provision of financing pursuant to such arrangements.[200] This relief may be afforded in the jurisdiction of the planning proceeding,[201] upon the application for recognition of a foreign planning proceeding,[202] or after such recognition.[203] The framework for approval of post-commencement financing established by the MLG goes further than that of the Directive.[204] The MLG allows approval and granting of rescue financing between related parties (i.e. group members). Moreover, these parties may be both financially distressed at the time when the group financial

[195] N Nisi, 'The recast of the Insolvency Regulation: a third country perspective' (2017) 13(2) J. Priv. Int. L. 324, 340, expressing doubts on whether the EU-centric approach of the EIR Recast is the best possible.
[196] UNCITRAL Working Group V, Enterprise group insolvency: draft guide to enactment, 28-31 May 2019.
[197] Article 2(f) MLG.
[198] Articles 71-75 EIR Recast.
[199] "Group representative" means "a person or body, including one appointed on an interim basis, authorized to act as a representative of a planning proceeding." Article 2(e) MLG.
[200] The draft versions of the MLG instead of "approving" and "authorizing" used less certain (from an ex ante perspective) – "recognizing". See Facilitating the cross-border insolvency of multinational enterprise groups: draft legislative provisions, March 2017. As noted above, when it comes to related-party transactions, ex ante approval is proportionate and serves the interests of both group entities (benefiting from legal certainty) and their creditors (benefiting from additional scrutiny).
[201] Article 20(g) MLG.
[202] Article 22(g) MLG.
[203] Article 24(h) MLG.
[204] The comprehensive cutting-edge character of the MLG has also been noted by Irit Mevorach, 'A Fresh View on the Hard/soft Law Divide: Implications for International Insolvency of Enterprise Groups' (2019) 40(3) Mich. J. Int. Law 505, 525.

support is afforded. Notably, the regime established by the MLG is flexible and the relief may be provided by and to the group entity[205] in the MLG jurisdiction and at different periods of time, including as an interim measure and before the actual recognition of a foreign planning proceeding.

The Draft Guide to Enactment of the MLG mentions criteria to be considered by courts when approving and authorizing post-commencement finance.[206] For example, the court may take into account whether post-commencement finance is necessary for uninterrupted operation or survival of a group member, or preservation or enhancement of its estate value and whether any harm to creditors of that enterprise group member may be offset by the benefits arising from performing the funding arrangement.[207]

Evidently, the success of this regime will depend on the willingness of jurisdictions to implement the MLG and participate in planning proceedings. Unlike the Directive, which is hard law binding on all EU Member States,[208] the Model Law is considered soft law and countries are free to adopt the MLG or refuse to do so. Nevertheless, the experience of the original Model Law, adopted in some 48 jurisdictions, shows the harmonising force of soft law instruments and the fact that soft law frequently "acts as a stepping stone for the development of hard law."[209] In my opinion, the MLG is capable of filling the gap in the regulation of intra-group rescue financing on an international level and supplement the Directive's partial approach.

8. Conclusion

Insolvency of corporate groups is a difficult subject in terms of finding common grounds and solutions acceptable across national borders. On the one hand, corporate groups are different in nature. Some are horizontally decentralized and consist of independent legal entities. Others are vertically centralized and integrated. On the other hand, whenever a group member or the whole group is in financial distress, the interests of various stakeholders may be at stake. This is particularly the case where, as a result of intra-group transactions, funds and assets are transferred between group entities to the disadvantage of (some) creditors. However, there can also be situations in which group financial support contributes to the stability of the group

[205] The draft versions of the MLG considered adding the phrase "participating in the planning proceeding", which would have limited the operation of group financing arrangements to such participating entities only. See Facilitating the cross-border insolvency of multinational enterprise groups: draft legislative provisions, March 2017. The final version of the MLG does not have such a requirement.
[206] The Guide uses the term "post-commencement finance", while the same term is not used in the MLG.
[207] Article 27 MLG prescribes that when granting relief, courts must be satisfied that "the interests of the creditors of each enterprise group member subject to or participating in a planning proceeding and other interested persons, including the enterprise group member subject to the relief to be granted, are adequately protected." The criteria proposed by the MLG overlap with those applicable under the BRRD.
[208] EU directives are legally binding. Nevertheless, unlike directly applicable regulations, directives need to be transposed (incorporated) into national legislation. Failure to do so may trigger a formal infringement procedure in accordance with Articles 258-260 TFEU.
[209] B Wessels, GJ Boon, 'Soft law instruments in restructuring and insolvency law: exploring its rise and impact' (2019) TvOB 53, 62-63. See Mevorach, arguing that that "a model law instrument could provide a proper replacement to formal treaty agreements" and that "a model-law type of instrument fits well with the internationalist role of cross-border insolvency law." I Mevorach, *The Future of Cross-Border Insolvency: Overcoming Biases and Closing Gaps* (OUP 2018) 167.

as a whole and prevents group disintegration, directly and indirectly benefiting the group members granting and receiving support.

This article addressed the issue of rescue financing in the context of corporate groups. It started with an introduction to three major principles of international insolvency law, namely equality of creditors, maximization of the insolvency estate value and protection of legitimate expectations and certainty of transactions. These principles are not always aligned with each other and compromises (balance) should oftentimes be sought. The context of an enterprise group does not deactivate the principles of insolvency law. However, the balancing exercise becomes more complicated and the policy choices may obtain special features and characteristics. For instance, the information asymmetries and "managerial" power of related parties may result in group opportunism, warranting additional precautionary measures and limitations. At the same time, such limitations should not lead to the complete break-up and disintegration of internal financial links, particularly in a situation of financial distress, when intra-group support may be especially needed. Maximization of the insolvency estate value requires coordinated group-wide approaches, recognizing a group structure and the role of individual group members. Considering the group context may also be in line with creditors' expectations, transacting with a selected group member, but counting on the group as a whole.

The newly adopted EU Directive on preventive restructuring frameworks recognises the utility and value of rescue financing. It creates a safe harbour, protecting interim and new financing from avoidance actions, and even provides for the possibility of granting priority to such financing. Unfortunately, intra-group support may be excluded from this safe harbour, which in practice is bound to create insurmountable problems for the operation of cross-border corporate groups. This article considers the potential exclusion of all intra-group financing transactions from the protective regime of the Directive to be sweeping and indiscriminate, and seeks to find a balanced and flexible approach to promote rescue, while preventing abuse. It does so with the analysis of different scenarios of group support, premised on the financial state of the providing and receiving entities. In this respect, the BRRD with its developed and harmonized regulation of group financial support arrangements becomes a useful reference point. Its embrace of the concept of a "group interest" and the conditions for approval and authorisation of group financial support are particularly noteworthy. Recognition of a group interest, in one form or another, is a prerequisite for developing effective insolvency and restructuring law responses to financial crises involving groups of companies.

This article does not offer a one-size-fits-all solution to the problems raised in the introduction. Instead, it makes four suggestions: 1) extension of the Directive's protective framework to cover intra-group financial support, 2) recognition at the European level of the "interest of the group" in the context of intra-group rescue financing, 3) establishment of an ex ante approval framework for certain pre-insolvency group support transactions, 4) adoption of guidelines or recommendations on relevant factors that courts, restructuring experts and creditors may take into account when approving intra-group financial support. Together, these elements can facilitate intra-group financial support to guarantee continued operation and survival of group entities and to safeguard the interests of various stakeholders involved.