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Navigating the International Waters of Insolvency Liability For Multinational Enterprises

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As the globalization of commerce continues unabated, more companies find themselves either establishing foreign subsidiaries or becoming multinational in scope, both to maintain their competitiveness and to further their business interests abroad. In other instances, an international merger renders the company a domestic subsidiary of a foreign parent corporation. In the absence of insolvency, this arrangement works well: a domestic company can hire local managers and professional service firms to navigate local business practices and customs, while at the same time building a global brand with support from its foreign affiliates. Centralized cash management, marketing and advertising, global strategy and the like from the 'home office' (whether in New York, Paris, or Tokyo) allow for efficient global management and allocation of resources. Finally, international affiliates of the enterprise are free to innovate and expand commercial operations in their respective country of operations.

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In the case of insolvency, however, matters become very complicated because there is little or no international uniformity on the law of debtor-creditor relations. The international community has recognized this void and has taken initial steps through the United Nations Commission on International Trade Law (UNCITRAL) to address some of these issues. For example, UNCITRAL has in recent years completed a Legislative Guide on Insolvency Law, as well as a Model Law on Cross-Border Insolvency, the latter of which has been adopted by many nations, including the U.S. Yet much more remains to be addressed.

The insolvency of the parent or one or more affiliates of a multinational enterprise immediately raises many questions, the first being which nation's insolvency laws will prevail. Yet the inquiry does not end there: even after determining whether one set of laws, or many sets of laws, will govern the insolvency of the entire enterprise, there is still the issue of allocation of value among the creditors of the various affiliates. Further, creditor claims may warrant different levels of scrutiny and priority, depending on the different governing law for each affiliate. This includes intercompany claims, which are often a matter of mere internal bookkeeping outside of bankruptcy, but can materially change the amount of value allocated from one affiliate

to another in a bankruptcy setting. Creditors of the 'poorer' insolvent affiliate may also seek 'consolidation' to gain access to the value of the 'richer' insolvent affiliate. In each of these situations, further complications arise if more than one court is involved for the various affiliates of the international corporate group.

The law of the many nations in this field is not harmonized. Indeed, the study of international insolvency matters remains in its infancy and, as a result, most companies facing multinational insolvency issues have proceeded on an *ad hoc* basis. While many multinational bankruptcy cases have benefited from the use of court-to-court communication procedures adopted for those cases, this approach typically only addresses procedural rather than substantive issues. Furthermore, coordination and cross-court communication is substantially hindered as some nations' laws preclude the court from communicating with other courts. Thus, each multinational insolvency case must often begin from scratch, instead of having established rules to resolve the substantive matters that are unique to multinational insolvencies.

At this stage in the early evolution of these issues, before we can even suggest or advocate a uniform law, the logical starting point is the thorough analysis of how each country addresses these complicated matters. The new initiatives and rulings in various countries that touch on the insolvency of corporate groups includes matters of corporate law, which often overlap with insolvency law where a multi-tiered corporate group is involved. Until there comes a time when there is a uniform law, it is absolutely imperative that international insolvency practitioners employ local counsel to navigate the often extreme and sometimes contradictory differences between the laws of different countries. The following examples highlight this need.[1]

Germany

In Germany, managing directors are required to file for bankruptcy within three weeks after grounds for insolvency have arisen (such as the inability to pay debts as they come due). The breach of this duty may result in civil, and possibly even criminal, liability for the directors. The duty to file for bankruptcy is not relieved by the honest, good faith beliefs of the directors that insolvency can still be avoided by favorable business decisions, including out of court restructuring efforts. The directors of a U.S. parent corporation, making decisions for its German subsidiary, who assume that they are operating under the business judgment rule, may quickly find themselves in a very unfortunate predicament. The three week period is statutorily proscribed as a maximum, and it begins upon the acquisition of positive knowledge of grounds for insolvency. Negligent lack of knowledge does not suffice to prolong the period. The consequence of this is that directors who believe they can "save" the company have no more than three weeks to do so.

As part of the penalty associated with such a conviction (or any criminal conviction for a corporate officer, including, *inter alia*, fraud, accounting irregularities, high risk speculative transactions. and reducing assets in a manner contrary to usual business practice) the responsible party is prohibited for a period of five years from becoming a member of the management board of a public corporation. More serious, however, and often unknown to foreign clients, is the consequence that all management board and managing director appointments become invalid *ex nunc*. This applies not only to the company in respect of which the crime was committed but to all companies in which the individual held such appointments.

England

England is one of several countries that recognize the concept of "shadow directors." When the directors of a foreign parent company, who are not directors of the U.K. subsidiary, either directly or indirectly manage the affairs of the subsidiary anyway, the U.K. subsidiary laws may render such people *de facto* directors or shadow directors of the subsidiary. A shadow director may be either an individual or a corporate entity. If a company's entire viability depends on support from its parent, it may be difficult for the parent to withdraw financial support without incurring liability as a shadow director. The directors of the parent will not, however, themselves become shadow directors of the subsidiary merely by passing board resolutions at the parent level, although they may if they individually and personally give directions to the directors of the subsidiary.

Conclusion

No nation has a monopoly on good ideas, including how best to allocate losses in a wasting corporate enterprise. The study of other countries' treatment of insolvent corporate groups enhances the ability of all corporate and insolvency professionals to assist their clients, and also to shape policy and development of the law at home. UNCITRAL has recently identified the topic of insolvent corporate groups as a priority area of study, and many other organizations are advancing the development of this subject, including the International Association of Restructuring, Insolvency and Bankruptcy Professionals and the International Insolvency Institute. By working together, and through continued, vigorous study and analysis of the different legal regimes covering insolvent corporate groups, we can further develop this area of international law, while also providing better advice to our international commercial clients.

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[1] For a comprehensive discussion of these issues from the viewpoint of 21 different countries, see J. William Boone, *Multinational Enterprise Liability in Insolvency Proceedings: Jurisdictional Comparisons* (1st ed. 2006).

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