CREDITOR PROTECTION WITHIN CORPORATE GROUP INSOLVENCY

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Abstract
Creditors of corporations in corporate groups are in a vulnerable position when the corporations become insolvent. The application of separate entity and limited liability principles makes the liability of the parent company for the debts of its subsidiary is limited to the amount of its shareholding in the subsidiary, even though in the commercial reality corporate groups are design for the interests of the group as a whole. The existing law in Indonesia has not provided adequate safeguards to creditors’ interests.

Keywords: creditor, corporate group, insolvency.

Intisari

Kata Kunci: kreditur, perusahaan grup, kepailitan.

Pokok Muatan
A. Introduction ................................................................................................................................ 124
B. Discussion .................................................................................................................................. 125
   1. Basic Principles of Corporate Groups ................................................................................. 125
   2. The Protection of Creditors’ Interests................................................................................. 128
C. Conclusion ................................................................................................................................. 135

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A. Introduction

Separate legal entity and limited liability are arguably the most important natures of corporations. Based on these natures, a corporation is an artificial legal entity separate from its shareholders, whose liability for the corporation’s debts is limited to the amount of their subscription to the company’s capital.\(^1\) This rule is extended to corporate groups where the shareholders are other corporations. The application of this rule inevitably encourages excessive risk-taking by the shareholders at the expense of creditors, in particular unsecured creditors who do not have a charge over the company’s assets or other means of guarantee to secure their loan to the company.

Since many years ago legal scholars have criticized the law for its inability to provide adequate safeguards to creditors of corporations, safeguards which should be a natural corollary of limited liability.\(^2\) This criticism referred to the early company law cases in England which were less protective to creditor interests, such as the *Salomon* case.\(^3\) In this case, the court strictly applied the separate legal entity and limited liability principles for the insolvency of a corporation named ‘A. Salomon and Co. Ltd’. Thus, Mr. Salomon as the majority shareholder was not liable for the company’s debts and liabilities. Since he was also a secured creditor, he was entitled to enforce debentures held by him ahead of the company’s unsecured creditors. The court stated that the creditors were responsible for their position by failing to examine the register of debentures, and there was no legal obligation on companies and their controllers “to warn those members of the public who deal with them on credit that they run the risk of not being paid.”\(^4\) This decision was described by Kahn-Freund as calamitous.\(^5\) Nevertheless, the principle in this decision is still upheld as a basic principle in modern corporate law in the common law jurisdiction.

Surprisingly, the protection of creditors remains an issue in this millennium age, particularly in corporate groups. The position of creditors in corporate groups is more vulnerable relating to the complex pattern of corporate groups. The recent case of PT Asuransi Jiwa Bakrie (Bakrie Life) provides an example of the vulnerable position of creditors within corporate group insolvency. In this case, Bakrie Life defaulted payments to investors of its Diamond Investa product, a mutual fund created in 2005.\(^6\) It was mentioned in the prospectus, that 90% of investors’ money would be invested in bonds, and investors would receive returns of up to 13% annually. The stock market crash of late 2008 made Bakrie Life in 2009 suspended interest payments and failed to return the initial investments to the investors. It was later revealed that 80% of the money was invested in equities, about half of which was in Bakrie Group Stocks.\(^7\)

Investors of Bakrie Life, which also can be regarded as creditors, have been waiting for almost two years. The company still owes Rp 290 billion to them. The President Director of Bakrie Life acknowledged that the company was insolvent and needed capital injection from its majority shareholder, Bakrie Capital Indonesia (BCI), which has not been able to inject any money because of their difficulties in raising funds.\(^8\) As a result, investors’ long wait for repayment of misused investment funds would continue indefinitely.

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4. Ibid., p. 40.
8. Ibid.
To some extent, Act Number 40 of 2007 on Limited Liability Company (Undang-undang tentang Perseroan Terbatas; UUPT) has provided some safeguards for the protection of creditor’s interests. Article 3 (2) of the Act allows piercing the corporate veil to make shareholders liable for the debts of the company, an exception of the limited liability rule guaranteed by Article 3 (1). Moreover, Article 104 (2) imposes a special obligation upon directors to take into account the interests of creditors in case of insolvency. These safeguards, however, in fact are not adequate for the protection of creditors’ interests and do not reflect the nature of corporate groups. The UUPT, therefore, needs to be reformed in order to enhance its protection to creditors of corporate groups. This article will analyse the appropriate safeguards should be adopted by the UUPT. It will refer to a variety of safeguards implemented in other countries to protect creditors’ interests within corporate group insolvency. First of all, it will explore some basic principles of corporate groups.

B. Discussion
1. Basic Principles of Corporate Groups
a. The Concept of Corporate Groups

It is necessary at the outset to outline what ‘corporate groups’ mean. In general term, ‘a corporate group’ refers to a group of companies which are associated by common or interlocking shareholdings and conduct business under common administrative or financial control. However, the legal and economic definitions of ‘corporate group’ vary across different jurisdictions and applicable legislation. In Indonesia, the UUPT unfortunately does not define ‘corporate groups’ as it does not specifically govern ‘corporate groups’. Thus, it is worthwhile to learn from other countries that have specific provisions on corporate group, such as Germany and Australia.

1) Germany

Stock corporations (Aktiengesellschaft/AG) in Germany are governed by the Stock Corporations Act (Aktiengesetz/AktG). The AktG provides for a comprehensive set of provisions governing affiliated corporations (verbundene Unternehmen) and corporate groups (Konzern), which can be found in Articles 15-19 and 291-337. According to Article 15, verbundene Unternehmen are:

1. a legally independent company, which holds majority shares or majority voting rights of another company;
2. dependent and dominant companies (abhängige und herrschende Unternehmen): a dominant company is one which can directly or indirectly exercise a controlling influence over another company which is termed the dependent company; a company is presumed to be dependent on another if the latter has a majority interest in it (Article 17);
3. groups of companies: a parent and one or more subsidiaries which come under a uniform, centralized management (einheitliche Leitung) form a corporate group (Konzern); or legally independent companies become a group if they are effectively operating under a uniform management;
4. companies with cross-ownerships, in which each company holds more than 25% of the total shares of the other company;
5. contractual shares of company’s contracts (Unternehmensverträge): company’s contracts are (1) the control contract (Beherrschungsvertrag), in which a stock corporation hands its management over another company; or (2) the profit-transfer contract (Gewinnabführungsvertrag), in which a stock corporation is committed to transfer its total profit to another company.

The AktG devises two specific categories of corporate groups: (1) the contractual group (Vertragskonzern); and (2) the factual or de facto group (faktische Konzern). A corporate...
group can opt to become a *Vertragskonzern* or a *faktische Konzern*.

The contractual group is based on the control agreement (*Beherrschungsvertrag*), which is a voluntary, contractual arrangement between the controlling parent company and the controlled subsidiary company. Pursuant to the *Beherrschungsvertrag*, the parent company is entitled to exercise management powers over the subsidiary.

Most corporate groups in Germany fall under the *faktische Konzern*.

9 This group is characterized by the absence of the *Beherrschungsvertrag* or any other contractual arrangement between parent and subsidiary addressing the group issue.

10 There are 2 factual requirements to establish a *faktische Konzern*: First, the parent company holds majority shares or majority voting rights of the subsidiary, which reflects the lack of independence of the subsidiary. Second, both parent and subsidiary companies are managed as a single, centralized enterprise (*Konzern*) under *einheitliche Leitung*.

2) Australia

Corporations in Australia are governed by the Corporations Act 2001. Unlike the German *AktG*, the Corporations Act 2001 (CA) does not define the expressions ‘group’ and ‘corporate group’, but the legislation applies two corporate group concepts: 1) holding, subsidiary and related body corporate; 2) parent companies and controlled entities.

**Holding, subsidiary and related body corporate.** Holding companies and all their subsidiaries are related body corporate, thereby forming a corporate group. Under Section 50 of the CA, a body corporate is related each other to another body corporate when: it is a holding company of another body corporate; it is a subsidiary of another body corporate; it is a subsidiary of a holding company of another body corporate.

The expression ‘holding company’ is defined in relation to the expression ‘subsidiary’ in Section 46 of the CA. A company is a subsidiary of another body corporate (the holding company) if, and only if:

a) the holding company:

- controls the board composition of another body corporate;
- controls at least 50% of the voting power of another body corporate;
- holds at least 50% of the share capital of another body corporate;

b) the company is a subsidiary of a subsidiary of the holding company.

**Parent companies and controlled entities.**

Australian accounting standards and the Corporations Act currently apply control tests to corporate groups for particular purposes. These tests are broader than the holding/subsidiary and related company tests.

‘Control’ is defined in Section 50AA in terms which extend to practical influence and which take account of practices and patterns of behavior, rather than just embodying a strict *de jure* test for control, which applies in relation to the subsidiary/holding company test. Section 50AA(1) states that for the purposes of the Corporations Act, an entity controls a second entity if the first entity has the capacity to determine the outcome of decisions about the second entity’s financial and operating policies.

**Others.** Besides those two concepts of corporate groups formulated by the Corporations

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11 Article 16 (1) of the *AktG*.

12 Article 18 (1) of the *AktG*.
Lestari, Creditor Protection Within Corporate Group Insolvency

Act, in reality there are still other groups of companies based on some forms of effective common control. First, it is possible to secure working control of a company well below the critical 50% threshold. Second, a group control might be based on a series of interlocking shareholdings just below the 50% threshold. The ability to achieve effective control over a group of companies based on a network of minority cross-shareholdings between the leading group members was exemplified by the Adelaide Steamship/David Jones/Tooth Group.

Whatever the concepts establish a corporate group, it is acknowledged by businessmen, accountants, investors, as well as lawyers and legislature that a corporate group is not merely ‘simple or complex combinations of individual companies’ but it is also a ‘significant entity for managerial, accounting and investment purposes’, which are designed for the group as a whole.

b. The Separate Entity Doctrine

The vulnerability of creditors can be traced to the separate entity doctrine of the corporation: the company is an entity separate and distinct from the owners of that organization. On the ground that one person is generally not responsible for the acts of another, the personification of the corporation as an entity gives result that shareholders are not responsible for the debts of another entity. Extending this rule to corporate groups would result that each company within a group is a separate entity and each of them cannot be held liable for the debts and liabilities of others, unless there are some special circumstances to justify piercing the corporate veil.

The application of the separate entity doctrine within the corporate group context, particularly within corporate group insolvency has been criticized cause the separate entity doctrine fails to capture the reality of corporate groups where it is the group as a whole which is “the significant entity for the managerial, accounting and investment purposes” rather than its individual member companies. Besides that, a significant potential for abuse lies in the corporate form being seen as a separate legal entity, whereby this abuse is exacerbated when the separate entity doctrine is combined with limited liability, which makes corporate groups as limited liability within limited liability.

Indeed, the separate entity doctrine itself has never been inviolable. If there are fraud and agency exceptions for piercing the corporate veil, limited liability would be abandoned only in extreme circumstances. In Indonesia, however, the courts are still reluctant to pierce the corporate veil in corporate group cases. For example, in a labor case between workers of PT Inti Fasindo International against PT Great River International, the parent company, the Labor Court rejected the claim made by the workers to hold the parent company liable for the non-fulfillment of the subsidiary’s liability. The court strictly applied the separate legal entity principle and held that the parent still enjoyed limited liability although the evidences showed that the subsidiary performed the parent’s instructions.

20 Ibid., p. 8.
In the U.K., the courts are more likely to pierce the corporate veil in corporate group cases than in other cases, but it is unlikely that the courts will hold a parent company responsible for the liability of its subsidiary. In the U.S., the approach ‘piercing the veil’ is far more broad-ranging and litigated than in Commonwealth countries. By adopting piercing the veil in corporate group context, plaintiffs could argue that subsidiaries were ‘mere instrumentalities’ or ‘alter egos’ of their parent companies, in order to reveal the separate entity status of the parent companies. Although the courts do not concretely define the rules on when piercing the veil should be applied to impose liability upon the parent companies, the success rate of the veil-piercing cases in the U.S. are relatively high.

In Australia, the courts are more prepared to pierce the corporate veil in cases of improper use of the corporate form and describe it as being devoid of any “common, unifying principle”. In corporate group cases, the courts regard complete control of the board of a subsidiary by its parent as insufficient to justify piercing the corporate veil. The court pointed out that were this not so, the corporate veil could be lifted in the case of almost every holding company and wholly-owned subsidiary. Nevertheless, a high level of control by a parent company over a subsidiary could, in some cases, trigger piercing the corporate veil.

Piercing the corporate veil as the exception of the separate entity doctrine, however, does not draw into the general concept of group responsibility. It has not been “a workable general solution” to deal with more specific forms of manipulation or abuse in corporate groups. Even less, there is no broad principle as to when the veil will be lifted, so that it remains uncertain when the group’s interests could be justified to be prevailed over the individual company’s interests, while commercial reality of the group designs the group business for the benefit of the group as a whole.

2. The Protection of Creditors’ Interests

The application of the separate entity doctrine and the limited liability principle has put creditors in a vulnerable position. A critical question in this area is whether creditors need protection or whether they should be expected to protect themselves. The answer of this question is still debatable. The debate divides those who consider that the market has provided all necessary protection to creditors from those who view that the existing forms of protection are only partially effective.

Hence, on the one hand, Posner argued that creditors have adequate protection through the interest rate charged on the loan which reflects not only the rental of the capital but also the risk that the borrower will fail to return it. He also stated that creditors will be unconcerned with the actual outcome of the venture since they will match the increase in risk with an increase in the interest rate. Moreover, in order to protect themselves, it is suggested that creditors can mention in their trust deeds some restrictions on activities of the company, such as restriction on the amount that the company can pay out as dividends and restriction on the company incurring debt of a similar or higher priority.

On the other hand, Landers argued that the rate of interest necessarily reflects only the risk perceived at the time loan was made, and any

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unforeseen change in that risk effectively lowers the rate of the interest, which in turn passes the cost of that debt to the lender.\textsuperscript{33} Also, the theory that creditors charge different interest rates for different levels of risk does not work where the costs of the creditors acquiring adequate information about the level of risk are disproportionate to the amount of the transaction. Furthermore, he asserted that even sophisticated creditors cannot foresee all contingencies and contract for protection against them such as when leveraged buyouts occur which transfer the wealth of sophisticated creditors to shareholders.

While the debate on creditor protection remains unresolved, there is no doubt that the onset of insolvency imposes a special obligation upon directors to take into account the creditors’ interests. Particularly in corporate groups, where the position of creditors is more vulnerable regarding the complex pattern of corporate groups and the separate entity doctrine, some protections for creditors upon the onset of insolvency with which they have contracted are warranted.

\textbf{a. Holding Company’s Liability}

Corporations Acts in some jurisdictions have advocated stepping aside the separate entity doctrine in corporate group insolvency by making parent companies to be liable for the debts incurred by their subsidiaries. However, they take different approaches in achieving the same goal.

1) German Kornzernrecht

The German law on corporate groups (\textit{Kornzernrecht}) developed a number of theories in the early 1920s for lifting the corporate veil on the basis of “control” by a parent company over a subsidiary. The \textit{Kornzernrecht} is intended to protect creditors and investors by requiring a parent company to compensate its subsidiaries for any losses that it may suffer due to its subordinate position.\textsuperscript{34} The subsidiary is entitled to a minimum of equitable funds. If these are taken away by the parent company the subsidiary may claim compensation, even in an insolvency proceeding. The arrangement of such compensations will depend on the type of the corporate group, either a contractual group or a factual group.

\textbf{The contractual group.} In the contractual group, the parent company is entitled to direct its subsidiary even if this disadvantages the subsidiary,\textsuperscript{35} as long as the directions meet two requirements.\textsuperscript{36} First, they have to be conducted for the interests of the corporate group as a whole.\textsuperscript{37} Second, they may not harm the separate legal existence of the subsidiary.\textsuperscript{38} As a \textit{quid pro quo}, the parent company must compensate the subsidiary for annual net losses incurred by those directions during the contract period.\textsuperscript{39} This compensation is obligatory regardless of any factual relationship, even if the casual link between the losses incurred by the subsidiary and the actual control exercised by the parent company is minimal.\textsuperscript{40} The parent company also has to provide sufficient reserve amounts in order to cover the fiscal loss suffered by the subsidiary. The compensation for the fiscal loss would be paid to the subsidiary at the end of the fiscal year. Where the parent company fails to compensate, the creditors of the subsidiary are entitled to enforce the subsidiary’s compensation claim against the parent company under the Bankruptcy Law.\textsuperscript{41}

\textsuperscript{35} Article 18(1) of the AktG.
\textsuperscript{37} Article 308(1) of the AktG.
\textsuperscript{38} René Reich-Graefe, \textit{Loc.cit.}
\textsuperscript{39} Article 302(1) of the AktG.
\textsuperscript{40} René Reich-Graefe, \textit{Loc.cit.}
\textsuperscript{41} Ibid., p.790.
The factual group. In the factual group, the parent company is not allowed to direct its subsidiary to enter into transactions which are disadvantageous to the subsidiary, unless the parent company provides compensation for such disadvantages in the same financial year. Should the parent company refuse to pay, the subsidiary is entitled to claim consequential damages. Every single interference by the parent company in the subsidiary’s management which detrimental to the subsidiary’s business interests will render the parent company to compensate the subsidiary for any and all damages suffered as a result of such singular interference.

Thus, the parent liability in the factual group is based on a case-by-case analysis. Besides that, the parent liability requires a causation nexus between the detrimental measure taken by the parent company and the damages or losses sustained by the subsidiary. Obviously, this mechanism differs from that in the contractual group, where the parent liability is provided for all subsidiary’s debts irrespective of any actual detriment caused by the parent’s control.

2) Australian Insolvent Trading Law
Part 5.7B, Division 5 of the Corporations Act, which encompasses Sections 588V-X, is currently headed ‘Liability of Holding Company for Insolvent Trading by Subsidiary’. Under these provisions, an action for compensation may be brought against a holding company where it allows a subsidiary company to trade while insolvent. The subsidiary’s liquidator may sue for compensation for the loss suffered by unsecured creditors as a result of insolvent trading by the subsidiary. A holding company contravenes the Act, in which contravention is one of foundations for compensation proceedings, if these requirements are met:

1) The company must be the holding company of a company at the time when the subsidiary incurs a debt.
2) The subsidiary company must be insolvent at that time or become insolvent by incurring that debt or by incurring at that time debts including that debt.
3) At the time when the subsidiary company incurs the debt, there must be reasonable grounds for suspecting that the company is insolvent or would become insolvent by incurring that debt or by incurring at that time debts including that debt, as the case may be.

4) Either of two alternatives may be satisfied:

- the holding company, or one or more of its directors, is aware when the debt is incurred that there are reasonable grounds for suspecting such insolvency; or
- having regard to the nature and extent of the holding company’s control over the subsidiary’s affairs and to any other relevant circumstances, it is reasonable to expect either that a holding company in the company’s circumstances would be so aware or that one or more directors of such a holding company would be so aware.

The liquidator of the subsidiary may recover compensation from the holding company for any losses resulting from insolvent trading by the subsidiary where four conditions are satisfied: (1) the holding company must have contravenes Part 5.7B, Division 5 in relation to the incurring of a debt by the subsidiary;

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43 Ibid.
45 Ibid.
46 Section 588W (1).
(2) the person to whom the debt is owed must have suffered loss or damage in relation to the debt because of the company’s insolvency; (3) the debt must be wholly or partly unsecured when the loss or damage was suffered; and (4) the subsidiary is being wound up. Where each of these requirements is satisfied, the liquidator of the subsidiary may recover from the holding company an amount equal to the amount of the loss or damage it has suffered. Several defenses for the purpose of proceeding for compensation under section 588W are provided by section 588X. Thus, it is a defense if the holding company can prove that:

1) At the time when the debt was incurred, it and each director who was aware that there were grounds for suspecting that the subsidiary was insolvent had reasonable grounds to expect, and did expect, that the subsidiary was solvent at the time and would remain solvent even if it incurred that debt and any other debts that it incurred at that time.

2) At the time when the debt was incurred, it and each director:
   - had reasonable grounds to believe, and did believe, that competent and reliable person was responsible for providing to the holding company adequate information about whether the subsidiary was solvent and that the other person was fulfilling that responsibility; and
   - expected, on the basis of the information provided to the holding company by the person that the subsidiary was solvent at that time and would remain solvent even if it incurred that debt.

3) The director did not take part in the management of the holding company at the time when the subsidiary incurred the debt because of illness or for some other good reason.

4) It took all reasonable steps to prevent the subsidiary from incurring the debt in question.

Sections 588V-X imposes incentives on the holding company to exercise appropriate care in dealing with its subsidiary. The sections, however, are criticized on several grounds. For a start, as mentioned in Chapter II of this article, there are some groups of companies which are not included under the definition of corporate groups recognized by the general law and the Corporations Act. Such group structure as Adsteam structure would not be classified as a holding company-subsidiary relationship and therefore would be outside of the scope of sections 588V-X. Sections 588V-X are also far from the notion of group liability. It operates only in one direction, namely to expose the holding company to liability for debts of the subsidiary, not vice versa.

b. Australian Cross Guarantee Scheme

Pursuant to subsection 341(1) of the Corporations Act 2001, the Australian Securities and Investments Commission (ASIC) makes a Class Order [CO 98/1418] relieving certain companies from the requirements of the Corporations Act 2001 to prepare and lodge a financial report, directors’ report and auditor’s report. Subject to certain conditions, relief is available to wholly-owned entities whose holding entity is a company or a registered foreign company.

The effect of the ASIC Class Orders is to require the subsidiary to enter into a prescribed deed of cross guarantee with its holding company and to prepare consolidated accounts. It was considered that, in view of the community of

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48 Ibid., p. 544.
50 Ibid.
interests between parent and wholly-owned subsidiary, consolidated accounts would more accurately reflect commercial realities.\(^{51}\)

The structure of the deed is in the form of a guarantee, in which each company within the group guarantees payment in full to each creditor of any debt in accordance with the deed. It is assumed that creditors would be adequately protected by the operation of an indemnity, which was designed, in the event of the insolvency of a company party to the deed, to give creditors access to the assets of other companies within the group.

In fact, however, the court still applied the separate entity principles in order to determine the inter-corporate liabilities under the cross guarantees. As a consequence, an odd result will be reached: the position of creditors of the insolvent company within the group will be improved, whereas, the access of creditors of a solvent company to the pooled fund will considerably diminished through the adoption of cross guarantees and set-offs.\(^{52}\) In other words, under the cross guarantee scheme, “the position of some creditors will be advanced to the detriment of others throughout the group.”\(^{53}\)

c. Related Company Liability

The notion of related company liability in insolvency has long been recognized in the U.S. (substantive consolidation) and New Zealand (contribution and pooling orders).\(^{54}\) The attraction of this concept is its flexibility. If a collection of companies has acted and presented themselves as a group, then *prima facie* there would be strong grounds for supporting the group responsibility. In contrast, if positive steps to separate the affairs of group members have been taken by these group members, the group responsibility would not be applied.\(^{55}\)

1) American Substantive Consolidation

Substantive consolidation is a legal process by which creditors may seek the pooling of the assets and liabilities of two or more companies in a group and the disregarding of intercompany claims between them by requesting the courts to disregard the separate legal entity of two companies (or in essence consolidate the two companies into one).\(^{56}\) This is referred to as “substantive consolidation” when carried out under the Bankruptcy Code and may be ordered in respect of two related entities each of which is subject to bankruptcy proceedings, or alternatively, it may be ordered where one related company is the subject of bankruptcy proceedings and the other is not.\(^{57}\)

American case law stresses the importance of affecting a result according to common notions of fairness while bearing in mind the cardinal rule of insolvency administration that there should be equality amongst creditors of the same standing. In *Re Gulfco Investment Corp*, the court stated that, notwithstanding their significant discretionary authority, courts must adhere to bankruptcy’s two fundamental policies of fair treatment of creditors and strict observance of the priorities that exist between various creditor classes.\(^{58}\)

Since the power to make an order for substantive consolidation is derived from an equitable background, the American Bankruptcy Courts in determining whether to order consolidation are guided by what is just

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55 *Ibid*.
58 593 F.2d 921 at 927.
and equitable in the circumstances.\textsuperscript{59} There are several factors mentioned in American cases as being relevant to determining whether it is just and equitable to order consolidation. The leading case in this matter is \textit{Re Augie/Restivo Baking Co.}\textsuperscript{60} The court in this case reviewed the various factors which had been mentioned in previous cases and considered that these factors were variants on two critical factors:

1) Whether the creditors dealt with the entities as a single economic unit and did not rely on their separate identity in extending credit. The court stated that creditors who made loans on the basis of the financial status of a separate entity expect to be able to look to the assets of the particular borrower for satisfaction of that loan. Such creditors structure their loans according to their expectations regarding that borrower, in which such expectations are central to the calculation of interest rates and other terms of loans and thus, fulfilling these expectations is important to the efficacy of credit markets.

2) Whether the affairs of the debtors are so entangled that consolidation will benefit all creditors. The court stated that substantive consolidation should only be used where there has been a co-mingling of two firm’s assets and business functions and consolidation is for the benefit of all creditors since untangling is either impossible or so costly as to consume the assets.

Moreover, the court recognized that these two factors merely aid the final determination of whether consolidation is warranted. The result is a balancing test as to whether the benefits of consolidation outweigh the harm that consolidation would cause to creditors. When the factors conflict or are absent, the courts determine whether the benefits outweigh the detriment to objecting parties. It is obvious from this case that arguments based on the reliance by creditors will be vital in any consideration by a court of an order for consolidation since voluntary creditors assess the risks of lending to a particular debtor and adjust it into the terms of the credit agreement.\textsuperscript{61} Reliance arguments will also be vital when the flow of funds inside the group has harmed one company at the benefit of another. In such circumstances, consolidation may be granted to ensure that creditors of that harmed company receive what they have bargained for contractually, whereas, creditors of the strengthen company will not be able to assert reliance arguments as they are left with their initial bargain and have no rights to the additional windfall.\textsuperscript{62} American Bankruptcy Courts, therefore, respect and promote the policy of fair treatment of creditors and will not order consolidation if it would deny such creditors the benefit of their bargain.

\textbf{2) New Zealand’s Contribution and Pooling Orders}

Under the Companies Act 1993 (as amended), New Zealand courts have a wide discretionary power to deal with related companies if one of the companies is insolvent and placed into liquidation. The court can order that a related company has to contribute to the assets available for winding up of the insolvent company if it is satisfied that it is just and equitable to make the order.\textsuperscript{63} If there are more than one related companies in liquidation, the court can wind them up as if they were one company if the court is satisfied that it is just and equitable to do so.\textsuperscript{64}

\begin{footnotesize}
\begin{enumerate}
\item Philip Blumberg, \textit{The American Law of Corporate Groups}, presented as part of the University of Sydney’s Faculty of Law Continuing Legal Education Program, 13 March 1992.
\item 860 F 2d. 515 (2\textsuperscript{nd} circ. 1988).
\item Richard Posner, \textit{Loc. cit.}
\item Stephen M. Packman, \textit{Loc. cit.}
\item Section 271 (1) (a).
\item Section 271 (1) (b).
\end{enumerate}
\end{footnotesize}
The basic legal position is that each company in a group is a separate legal entity. In practice, however, a group is often run as one business by a single management, in which transactions within the group are not necessarily on a commercial basis and one subsidiary may be sacrificed for the benefit of the group as a whole. In such circumstances, unsecured creditors of that subsidiary may be left without recourse to adequate assets to meet their claims. Accordingly, requiring a company to contribute to its related company’s assets and winding up related companies together, although it challenges the separate entity principle, can be justified.

The provisions of contribution and pooling orders adopt the concept of related companies. Section 2(3) defines the term of related companies, in which a company is related to another if:
1) the other company is its holding company or subsidiary; or
2) more than half of the nominal value of its equity share capital is held by the company and companies related to that other company; or
3) more than half of the nominal value of the equity share capital of each of them is held by members of the other; or
4) the business of the companies have been so carried on that the separate business of each company, or a substantial part thereof, is not readily identifiable; or
5) there is another company to which both companies are related.

In considering making a contribution or pooling order, the court must determine whether it is just and equitable to make the order. In a judgment concerning the words ‘just and equitable’ in the Companies Special Investigations Act 1958, the court stated that pooling provisions in Section [271 (1)(a) and (b)] demonstrated the legislative acceptance of the importance of equality in the distribution of an insolvent company’s assets.

Section 272 (1) provides several factors to be determined by the court to make a contribution order under Section 271 (1)(a):
1) the extent to which the related company took part in the management of the company being wound up;
2) the conduct of the related company towards the creditors of the company being wound up;
3) the extent to which the circumstances that have given rise to the winding up of the company are attributable to the actions of the related company;
4) such other matters as the court thinks fit.

According to Section 272 (2), to make a pooling order under Section 271 (1)(b), the court is required to consider:
1) the extent to which any of the companies took part in the management of the other companies;
2) the conduct of any of the companies towards the creditors of the other companies;
3) the extent to which the circumstances that gave rise to the winding up of any of the companies are attributable to the actions of the other companies;
4) the extent to which the business of the companies have been intermingled;
5) such other matters as the court thinks fit.

In the case involving a contribution order, Lewis v. Poultry Processors, there was evidence that a contribution might threaten the solvency of the related company. The court submitted that Section [271 (1)(a)] is not intended to threaten the solvency of the related company. It was also stated that if the contribution sought from a related company threatens that company’s solvency, then

65 Section 15.
66 Anthea Nolan, Loc.cit.
67 Re Home Loans Fund (NZ) Ltd. (in liq.) (1983) 1 NZCLC 95,583.
68 (1988) 4 NZCLC 64,508.
the court must consider the equities involved affecting the creditors of that company, whereby these creditors will rely on arguments that they had relied on the separate assets of the company when trading with it and should not be denied a full payout because of that company’s relationship with another company.

It is possible that the motive of each creditor of the related company differs each other, or the motives of creditors are not clear at the time they deal with the company. In such circumstances, the courts have held that the aim of the contribution order is to produce result which is beneficial to the creditors as a whole.\(^69\) However, if the claims of competing creditors appear to be equally meritorious, it is suggested to accompany analysis of the flow of funds between group members.\(^70\)

### C. Conclusion

A variety of safeguards for creditors of corporate groups have been implemented in some jurisdictions. Not all of them, however, are effective in protecting creditors’ interests within corporate group insolvency. Under Australian laws, the position of creditors is still vulnerable as the laws fail to provide adequate safeguards for them. The cross guarantee scheme, in fact, presents a detriment to the creditors of solvent companies, although the position of creditors of an insolvent company throughout the group will be advanced. Besides that, the scheme cannot deal with multiple insolvency cases. The narrow definition of corporate groups given by the Corporations Act provides a potential avoidance of having liability under sections 588V-X. Moreover, the law does not reflect the general notion of group responsibility.

The German Stock Corporations Act provides a systematic legal regulation on corporate groups and already adopts enterprise law or group responsibility. It is significantly more protective of creditors and investors than the separate entity approach adopted in common law jurisdictions. Hence, it is suggested that Indonesia adopts the German concept on corporate groups which stresses on group responsibility instead of separate entity and limited liability.

The UUPT does not necessarily regulate corporate groups in Indonesia exactly the same as the German Konzernrecht, but at least it adopts the basic concept of group responsibility. For the protection of creditors’ interests, therefore, the UUPT should have specific provisions on corporate groups and treat corporate groups differently from single companies. Under such provisions, the controlling company must compensate the controlled company for any losses incurred by the direction of the controlling company. Should the controlling company refuse to compensate, the controlled company and its creditors can claim for consequential damages.

Where the controlled company is insolvent and under the bankruptcy proceeding, the UUPT could adopt New Zealand’s Companies Act which gives courts a wide discretionary power to order the controlling company to contribute to the assets available for the liquidation of the insolvent company, if the court is satisfied that it is just and equitable to do so. In case of multiple insolvencies, the laws on substantive consolidation in the U.S. and pooling orders in New Zealand could also be adopted. Thus, assets and liabilities of solvent and insolvent companies within a group are pooled in order to meet claims from creditors of insolvent companies. The application of this rule, however, should not threaten the existence of solvent companies.

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\(^{69}\) Re Home Loans Fund (NZ) Ltd. (in liq.) supra n.81; Re Pacific Syndicates (NZ) Ltd. (in liq.) supra n.78; Re Gazing & Export Meat Co. Ltd. (1984) 2 NZCLC 99,226.

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