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13 – 15 March 2011	Singapore	INSOL International Annual Regional Conference	INSOL Singapore
31 March + 01 April 2011	Mailand	INSOL Europe Academic Forum Conference	INSOL Europe
26 – 28 May 2011	Tallinn (Estonia)	Eastern European Countries Committee	INSOL Europe
22 – 25 September 2011	Venice	Annual Congress	INSOL Europe
28 April 2011	Amsterdam	Conference in cooperation with European Commission on Reform of The European Insolvency Regulation	RESOR/INSOL EUROPE
21 + 22 September 2011	Venice	INSOL Europe Academic Forum Conference	INSOL Europe
22 – 25 September 2011	Venice	INSOL Europe Annual Congress	INSOL Europe

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Articles

Professor Dr. Héctor José Miguens, LLM*

The Liability of Parent Corporations under the Argentine Bankruptcy Act

A number of modern authors[1] have noted the diminishing acceptability of the concept of entity law and the concomitant emergence of the doctrine of enterprise law with respect to many aspects of the legal relationship between parent and subsidiary corporations. This shift of opinion is highly significant because it reflects a growing reluctance on the part of courts and legislatures to accept a traditional view of corporate law that arguably no longer corresponds to the reality of modern business enterprises in a complex industrialised international society.

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1 See, inter alia, Phillip I. Blumberg, The Law of Corporate Groups, Problems in the Bankruptcy or Reorganization of Parent and Subsidiary Corporations, Including the Law of Corporate Guaranties, at xxxiv (Little, Brown and Co., Boston. 1985) [hereinafter Blumberg]. For the relevance of corporate groups, see, among many others, U. N. Transnational Corp. and Mgmt. Div., 1993 World Inv. Rep. Studies, cited in *Survey, Multinationals-Back in Fashion*, The Economist, Mar. 27, 1993.

Introduction

The traditional view that for most purposes each corporation is a separate legal entity with its own legal responsibilities is in a process of demise. This is especially true of situations where the corporation in question is a constituent part of a corporate group carrying on an integrated enterprise. In many areas, "*enterprise law*", a term coined by Philip I. Blumberg, is gaining increased acceptance as the preferred concept by which to analyse legal problems of parent and subsidiary corporations.

The new doctrine, suggested by Blumberg following trends in US case law, seeks to trace the decline of *entity law* and the emergence of *enterprise law* as the standard by which to assess corporate groups and their constituent corporations. *Entity law*, the view that each corporation is a separate legal personality, has a strong intellectual history. The significance of the concept was reinforced by the acceptance of the doctrine of limited liability in the early nineteenth century in the United States and, several decades later, in England. With the development of limited liability for shareholders, *entity law* became firmly established as the legal framework preserving a bright line of demarcation between the corporation conducting the enterprise and the shareholders owning that enterprise.

To conduct economic undertakings of great magnitude, the large enterprise is inevitably driven to abandon simple twentieth century forms of corporate organisation and to develop increasingly complex corporate structures. Today, large corporations almost universally conduct business through multiple subsidiary corporations – for tax, accounting, political or administrative reasons, or to avoid qualification under foreign corporate statutes. The parent and its subsidiaries together constitute a corporate group that collectively conducts the business of the enterprise throughout the world[2]. In some cases, the subsidiaries conduct truly separate businesses and most often the subsidiary is only a part or fragment of the larger business of its parent, which is collectively conducted by the various affiliates under common direction.

The typical major enterprise has developed a highly complex structure with various parts of the business allocated to numerous subsidiaries according to function (sales, manufacturing, finance, human factor, accountability, enterprise direction or the like) or geography. The distinction between the subsidiary corporation and its shareholder – the parent – no longer neatly corresponds to the distinction between the enterprise and the ultimate investor, which was the notion at the very heart of the concept of *entity law*. The parent and subsidiary now together represent the enterprise. The old law of entity, reflecting the older world of simple business organisationshas become anachronistic – particularly where issues of substantive liability are not involved.

In the area of bankruptcy law, and to a lesser extent in procedure, the objectives and underlying policies of the law do not typically involve concerns of limited liability. In bankruptcy, the courts – especially in the US – act as courts of equity with the overriding objective of achieving equality of distribution and fairness to

2 For example, in 1982 the 1,000 largest American industrial corporations had an average of 48 subsidiaries each. Mobil Oil Corporation, as an extreme example, operated in 62 different countries through 525 subsidiaries. *See* BLUMBERG, *supra* note 1, at 465-68.

creditors. Thus, it is to be expected that where a bankruptcy involves one or more members of a corporate group, the courts will often treat transactions between the bankrupt debtor and its parent, controlling shareholder or affiliated corporation in a manner that differs from how they treat transactions between separate unrelated legal entities. Increasingly, bankruptcy courts have abandoned *entity law* and applied *enterprise law* to transactions involving "*insiders*" in order to achieve the goals of equality of distribution and fairness to creditors. The shift towards *enterprise law* is particularly evident in the areas of equitable subordination and substantive consolidation. However, this new approach is equally valid – though less evident – in other areas of bankruptcy of corporate groups such as liability issues.[3]

The Insolvency Law Concerning the Matter in Argentina

The Argentine insolvency law concerning corporate groups is an example of a developed law on the matter within the context of the European Civil Law System. This is true especially in relation to the substantive and procedural provisions on the "*extension of the bankruptcy proceedings*" as well as in relation to the doctrine of "*piercing the corporate veil*" where the Argentine law provides the first legal text on the matter in any Civil Law country. The two doctrines are applicable – specifically or by analogy – to corporate groups in insolvency.

In this paper we analyse the provisions of the Argentine Bankruptcy Act on the liability of the parent for debts of the insolvent subsidiary. We do not consider provisions of the Argentine Company Act or of the Argentine Civil Code.

A. The Liability of Third Parties

Under the Argentine Bankruptcy Act system there is only one provision covering the liability of third parties in the case of bankruptcy, contained in section 173 of the Bankruptcy Act as of 1995. As a general rule under section 173.2 of the Bankruptcy Act, the dominant party can be made liable in the event of bankruptcy. Normally the law penalises a person as a counterpart of the company for benefiting from any reduction of assets. Thus, it is reasonable that it must penalise the worst case in which the third party not only takes part in that reduction but also in the decision-making process of the damaged company. The additional consequence is the loss of all rights in insolvency proceedings[4]. This provision was enforced for the first time in 1972, by the Bankruptcy Act number 19.551.

This provision is applicable both in the case of *de facto* and *de jure* directors of the insolvent company. It is necessary that the conduct of the dominant party be fraudulent and not merely negligent in relation to corporate governance. The parties with legal standing to claim the action are (a) the Trustee in Bankruptcy, and (b) the creditors in the bankruptcy proceedings. The goal of the provision is to substantially punish the violation of the duty of the debtor to maintain the solvency of his patrimony[5].

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3 *See* Blumberg, *supra* note 1, at xxxiv-xxxvi.
4 *See* Rafael Mariano Manovil, Grupos de sociedades en el derecho comparado, Abeledo-Perrot, Buenos Aires 1998, 773, 779.
5 See Manóvil, op. cit., ps. 672, 775.

Unfortunately, there is no case law concerning corporate groups, but in my opinion the leading US insolvency cases on corporate groups are strong examples indicating the future for countries under the European Civil Law System.

B. Extension of the Bankruptcy Proceedings

In 1969 there was a *draft Bankruptcy Act* in Argentina that, by section 168, promoted the automatic extension of bankruptcy proceedings to the parent in the event of the bankruptcy of a subsidiary corporation . Due in large part to the rigidity of its provisions, the draft Act was rejected by legislators and lapsed.[6]

However, the Bankruptcy Act of 1972 closely mirrored the provisions of sections 99 and 101 of the French Bankruptcy Act of 1967 (and the subsequent sections 180 and 182 of the French Bankruptcy Act of 1985), entitled "*extension de faillite*" ("extension of bankruptcy"). Moreover, the Bankruptcy Act of 1983 increased extension to third parties and enshrined additional provisions regarding the consequences of extension. It also made it possible to extend the bankruptcy to any individual or corporation, a provision recapitulated in section 161 in the later Bankruptcy Act of 1995. These rules are applicable to corporate groups by analogy. For some authors, like Manovil, this extension of bankruptcy may be considered a type of liability[7]. Regarding the *onus probandi* matter, the modern theory of *"dynamic burdens"* imposes the obligation on the party that is in better condition to produce evidence. According to Argentine Procedural Law a judge can also order *ex officio* any means of proof, independent of that offered by the parties..

In Argentina, there has been intense discussion surrounding this provision because of its perceived rigidity[8]. Some commentators have argued that it would is prefereable to have a system of liability rather than proceedings allowing for the "extension the bankruptcy", especially within corporate groups[9]. At the extreme end, a system of liability still allows for the possibility of obtaining a bankruptcy decree with a ruling imposing liability on the parent corporation.

The "Swift-Deltec" case of 1970 was the biggest bankruptcy of its time in Argentina and an important antecedent to the Bankruptcy Act of 1972, which introduced the "*the extension of the bankruptcy proceedings*" into a legal statute for the first time.[10] Undoubtedly, the full ramifications of this case may not yet

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6 The text of Section 168 was: "Bankruptcy of a controlled company results in bankruptcy of the controlling company, a controlling company being defined as a company that directly or through another controlled company, holds interest, for any title whatsoever, in excess of 50% of the voting stock necessary to adopt decisions". S*ee* 29 *El Derecho* 917 (1969).

7 See Manóvil, op. cit., ps. 1113, 1117. I totally agree with this opinion.

8 *See ibídem,* at 1059, 1062 (mentioning authors). Some authors opposed to this legal provision offer reasons such as: the need for conservation of the enterprise, the complexities of a multinational bankrupt group, the uncontrolled expansion of the macroeconomic crises, the loss of income due to judicial liquidation, the loss of going concern value, and the imposition of bankruptcy proceedings upon a corporation without evidence of insolvency. I am of the same opinion, substantially for the same reasons.

9 *See* A. Tonon, "Extension de Quiebra sin Finalidad Practica," 107 El Derecho, 843 (1984); Héctor José Miguens, Extension de la quiebra y responsabilidad en los grupos de sociedades, 2º edition, Depalma, Buenos Aires, 2006, p. 479 and *passim*).

10 "Compania Swift de la Plata SA", first instance sentence of 8 November 1971 in El Derecho vol. 43-130 ss.; National Commercial Court of Second Instance, Sala C, second instance sentence of 6 June 1972 in Jurisprudencia Argentina, vol. 15 (1972) ps. 349 et ss; Supreme Court

be realised.[11] The applicable law and jurisdiction of the court to decide on the extension of bankruptcy are those of the main bankrupt debtor. Yet substantial difficulties are faced by the courts of a foreign jurisdiction in recognising a bankruptcy declared beyond its frontiers. These difficulties constitute another argument in favor of exercising liability actions rather than extending bankruptcy.[12] This is especially applicable to the "*Swift-Deltec*" case, because the bankruptcy decree would likely have been rejected outside Argentina, or at least not formally accepted by a court where the US assets were located. Indeed in the decades followingthe case,the Argentine Trustee in Bankruptcy of the debtor "Compañía Swift de La Plata" did not pursue any litigation on that point in the US.

The extension of the bankruptcy proceedings has been imposed both before and after 1972 in cases concerning corporate groups. In some cases the courts have denied the extension within corporate groups due to procedural reasons. However in one case, that of "Greco" dating from the 1980s, the National Government has specifically put in force special regulations for a whole group (22.229 and 22.334). The extension of bankruptcy due to conduct originating in self-interest (section 161.1 of the Bankruptcy Act of 1995) is not limited to cases of straw men. It punishes conduct with a causal link to the insolvency. The identity of the beneficiary of such conduct is not of importance, nor is the issue of whether the damage or eventual insolvency was intended. Even the element *fraud to creditors* is superfluous and can be ignored.[13] Rather the issue is whether the conduct was contrary to the interests of the main debtor.

There is no reason under Argentine law to hold the position that in insolvency proceedings intragroup creditors can be subordinated, as is the case under US law, or denied relief, as is the case in other jurisdictions. With repect to the voting rights of creditors in preventative insolvency proceedings, the exclusion of the controlling shareholder under the new section 45 of the Bankruptcy Act of 1995 embraces all kinds of control, and, according to the rationale for the rule, also embraces all creditor corporations whose decision-making process is under the charge of that controlling shareholder.[14]

The extension of bankruptcy to the controlling party due to corporate interest deviation by section 161.2 of the Bankruptcy Act is accompanied by an ineffective assortment of terms and super-abundant requirements, including: (a) all deflection of the corporate interest (the rule refers to the interest *of the company*)

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of Argentina, sentence of 4 September 1973 in El Derecho vol. 83, p. 591 et ss. and in La Ley vol. 151 ps. 516 et ss.

11 This case was a so-called "*concurso preventivo*," similar to a "*Reorganization*" in the U.S. Bankruptcy System. The judge of first instance, the Commercial Court of Appeals of Buenos Aires (Sala C) and the (Federal) Supreme Court of Argentina, applied the doctrine of "*piercing the corporate veil*" and with this argument rejected the proposal of the debtor, declared the the subsidiary bankrupt, and extended bankruptcy proceedings from the subsidiary to the whole group, with some of the companies located in Argentina and others in the US. Also the creditors of the parent corporations were not considered for election under the "*concurso preventivo*" plan, although in Argentina subordination of creditors in bankruptcy does not exist and there was no conflict of interest allowing a a parent to vote in the bankruptcy proceedings of a subsidiary, as defined in the new Section 45 of the Bankruptcy Act of 1995.

12 See Manóvil, op. cit., at 1233.

13 Idem, at 1232.

14 Idem, at 1231.

is unlawful; (b) reference to the beneficiary of the conduct of the person to whom the rule is applied is of no material relevance; and (c) the means to produce the deflection of the coporate interest and submission to unified management, which is not consistent with the fact that the rule attaches effects to the exercise of control and not to the configuration of a group. In itself, the extension of bankruptcy proceedings is not a repressive civil penalty but a case of tort liability that requires all its configuring elements. The most relevant of these elements is the causal link between the conduct displayed and the insolvency, both in its chronological aspect and in its quantitative and qualitative aspects.

The extension of bankruptcy due to commingling of assets (section 161.3 of the Bankruptcy Act) also includes subjective commingling and is difficult to assess. It is more frequent that the formation of a sole estate be declared due to the commingling of assets than to find an isolated case of extension of bankruptcy for this reason. It is necessary to consider each case on its merits because it is impossible to quantify in the abstract. In the case of self-interested actions and commingling, bankruptcy may be extended to any kind of subject. Therefore, it also extends to any type of controlling person. However it is only direct or indirect, legal (*de jure*) or factual, internal controllers, and not external controllers, that can be the subject of the extension of bankruptcy due to the deviation or deflection of the corporate interest[15]. Save for the case of commingling of assets, the horizontal extension of bankruptcy, which is to say the extension to affiliate corporations of the same parent, has no legal foundation in any Argentine Act[16].

C. Some conclusions

In the case of insolvency, the extension of bankruptcy proceedings under the Argentine Bankruptcy Act is not always the most adequate answer to the interests of the bankrupt state, particularly where that extension is to the controlling party. On the contrary, the actions of liability for the abuse of control in section 54.1 and 54.2 of the Companies Act of 1983, or the declaration of ineffectiveness of a legal personality, or section 54.3 of the Companies Act, or even responsibility under insolvency proceedings by section 173 of the Bankruptcy Act, may provide more effective means for safeguarding bankruptcy interests.

Also of note is the legislation concerning the extension of bankruptcy proceedings to corporate groups by analogy. However in my opinion the norms regarding liability (applicable in the case of corporate groups directly or by analogy) are preferable, because they are more flexible,reliable and proportionate to the damaged caused, particularly in the case of multinational corporate groups in insolvency.

15 See *idem*, p. 1232.
16 See *idem*, p. 1233.