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Applicable law in insolvency proceedings

Note by the Secretariat

Contents

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I. Introduction

1. The background information about the project on applicable law in insolvency proceedings referred to the Working Group by the Commission at its fifty-fourth session,[1] may be found in the provisional agenda of the fifty-ninth session of the Working Group (A/CN.9/WG.V/WP.173). It indicates that the Commission found the topic complex, requiring a high level of expertise in various subjects of private international law, as well as on choice of law in areas such as contract law, property law, corporate law, securities and banking and other areas on which the Commission has not worked recently. In the light of a broad range of issues that the topic touches, the Commission considered it essential to delineate the scope of the work on the topic carefully.[2]

2. This note was prepared to facilitate an initial consideration of the topic by the Working Group. It was prepared on the assumption that the Working Group might wish: (a) to use recommendations 30–34 and accompanying commentary of the UNCITRAL Legislative Guide on Insolvency Law (the "Guide") as the starting point for its deliberations on the topic; and (b) to focus first on *lex fori concursus* and exceptions thereto in the context of a simple scenario – an insolvency proceeding with respect to a single debtor – taking up any other issues of applicable law in insolvency proceedings (for example, those arising from concurrent insolvency proceedings and enterprise group insolvency) at later stages. Consequently, this note does not address rules for the localization of assets, law applicable to the rights and claims existing at the time of the commencement of insolvency proceedings (other than briefly in the context of recommendation 30) or other rules of private international law.[3] Depending on the Working Group's decision on the scope of the project, those issues may become the subject of a separate study that would need to be undertaken in close cooperation with the Hague Conference on Private International Law (the HccH).

3. This note should be read together with the report of the Colloquium on Applicable Law in Insolvency Proceedings (Vienna, 11 December 2020) (A/CN.9/1060) (the "Colloquium report"). Chapter II of the note recalls the consideration of the topic by the Working Group at its earlier sessions. Chapter III reproduces the contents of recommendations 30–34 and accompanying commentary of the Guide for ease of reference by the Working Group and highlights issues raised by those recommendations. Chapter IV lists issues that the Working Group may wish to consider as regards the scope of the project.

4. References are made throughout the note to surveyed international and regional texts of relevance to the project, in particular Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (recast) (the "EIR recast")[4] and to the Global Rules on Conflict-of-Laws Matters in International Insolvency Cases of the American Law Institute and the International Insolvency Institute, including comments and the Reporters' notes (the "Global Rules"). The national insolvency laws surveyed by the secretariat did not contain provisions similar to those found in recommendations 30–34 of the Guide.

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[1] *Official Records of the General Assembly, Seventy-sixth Session, Supplement No. 17* (A/76/17), paras. 215–217.

[2] Ibid., *Seventy-fourth Session, Supplement No. 17* (A/74/17), para. 206; and ibid., *Seventy-sixth Session, Supplement No. 17* (A/76/17), para. 217.

[3] They are numerous and found in various sources of law, including international texts. See e.g., the HccH Convention on the Law Applicable to Certain Rights in Respect of Securities held with an Intermediary; or the UNCITRAL Model Law on Secured Transactions (chapter VIII).

[4] Binding and directly applicable in European Union (EU) member States. Its scope is limited to proceedings in respect of a debtor whose centre of main interests is located in the EU (see recital 25). It replaced and superseded Council Regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings (the EIR), which in turn was based on the European Union Convention on Insolvency Proceedings (done at Brussels on 23 November 1995; did not enter into force) (the EU Convention).

II. Summary of past consideration of the topic in the Working Group

5. Recommendations 30–34 and the accompanying commentary in the Guide address applicable law in insolvency proceedings. They resulted from deliberations of the Working Group at its twenty-ninth session (Vienna, 1–5 September 2003) on the basis of a note by the Secretariat (A/CN.9/WG.V/WP.63/Add.17)[5] and at its thirtieth session (New York, 29 March–2 April 2004) on the basis of a note by the Secretariat (A/CN.9/WG.V/WP.72 which content replaced section D following paragraph 652 of A/CN.9/WG.V/WP.70 (Part II)).[6] The prevailing view at the twenty-ninth session had been that issues of applicable law were of key importance to insolvency proceedings and that material on the issues involved should be included in the Guide to provide assistance and guidance to legislators and other users. As to the extent of the material to be included, some concern had been expressed that discussion and finalization of provisions on applicable law should not delay progress on the Guide.[7] The Working Group requested the UNCITRAL secretariat to develop the relevant material in consultation with the HccH[8] (see in that context also paras. 7 and 41 of the Colloquium report). At its thirtieth session, the Working Group had approved the draft recommendations and the commentary contained in A/CN.9/WG.V/WP.72 with some amendments.[9] As was suggested at that session,[10] they were included in chapter I of part two of the Guide. The issues that had been raised with respect to those recommendations and draft commentary in the Working Group at that time are recalled below in the relevant contexts.

6. At its thirty-seventh session, in 2004, the Commission adopted the draft recommendations and the commentary contained in A/CN.9/WG.V/WP.72 unchanged, except for: (a) moving one recommendation to part one of the Guide and amending it (which became the current recommendation 3 in the Guide reading: “The insolvency law should recognize rights and claims arising under law other than the insolvency law, whether domestic or foreign, except to the extent of any express limitation set forth in the insolvency law.”); and (b) adding the following sentence at the end of the commentary to recommendation 33 on labour contracts: “In some States, such protections will apply only to individual employment contracts, while in others, these provisions also will apply to collective bargaining agreements.”[11]

7. Since the inclusion of those recommendations and the commentary in the Guide, the Working Group has considered the topic of applicable law in insolvency law on a few occasions, both as part of a possible comprehensive convention on insolvency

[5] A/CN.9/542, paras. 28–43.

[6] A/CN.9/551, paras. 24–32. Paragraph 24 of that report notes that A/CN.9/WG.V/WP.72 was subject to consideration also by UNCITRAL Working Group VI (Security Interests) which found the principles contained in A/CN.9/WG.V/WP.72 to be generally acceptable.

[7] A/CN.9/542, para. 28.

[8] Ibid., para. 43.

[9] A/CN.9/551, paras. 24–32.

[10] Ibid., para. 32.

[11] *Official Records of the General Assembly, Fifty-ninth Session, Supplement No. 17* (A/59/17), paras. 18 and 50 (ff).

law[12] and as a stand-alone topic.[13] On those occasions, the Working Group expressed support for undertaking work on that topic as a matter of priority, highlighting that the topic raised issues that were key to many of the topics considered or proposed to be considered by the Working Group and that the work should be undertaken in coordination with other international organizations with expertise in the area of choice of law, such as the HccH.[14]

8. The following key issues were identified for discussion under that topic at that time: (a) applicable law for ranking unsecured claims; (b) choice of law for intellectual property or other intangible property rights; (c) distinguishing "procedural" insolvency rules from those that affect substantive entitlements (ordinary private international law principles might continue to govern questions of non-insolvency law such as the validity or non-validity of claims); (d) identification of particular matters where local interests dominate; (e) exploring when the law of the forum would conclusively determine the governing insolvency principles (whether that forum was a main or non-main proceeding); (f) identifying when the forum court in a non-main proceeding should apply the insolvency law of the main proceeding; (g) identifying other circumstances where a forum court might defer to the insolvency law of another jurisdiction (whether or not a proceeding was pending in that other jurisdiction); and (h) applicable law in the context of enterprise groups.[15]

III. Issues raised by recommendations 30–34 and accompanying commentary

A. General

9. Recommendations 30–34 and the commentary thereto form an integral part of the core provisions of the Guide for an effective and efficient domestic insolvency law framework recommended by UNCITRAL. They should be read together with other parts of the Guide, including the Glossary found in the Introduction to the Guide. Particularly relevant to the project are those sections that address protection of creditors and provisions that aim to ensure that rights and claims arising under other laws are generally recognized in insolvency (see e.g., para. 6 above and also recommendations 4 (supplemented by recommendation 88) and 100). They may explain policy choices made when the section of the Guide on applicable law in

[12] See the report of Working Group V (Insolvency Law) on the work of its thirty-seventh session (Vienna, 9–13 November 2009) (A/CN.9/686), paras. 127–128, specifically para. 128 (b). At that session, the Working Group received a proposal by the Union Internationale des Avocats (UIA) on a possible international convention in the field of international insolvency law. It was proposed that a convention might address, among other issues, applicable law in insolvency proceedings, or applicable law issues could be included in a separate protocol to such a convention. The Working Group deferred the consideration of that proposal, together with other proposals for possible future work, to a future session. That proposal was subsequently supported by the International Bar Association (see A/CN.9/WG.V/WP.93/Add.6, paras. 3–11 that was before the Working Group at its thirty-eighth session (New York, 19–23 April 2010)). See also a subsequent note by the Secretariat providing background information on topics comprising the then current mandate of Working Group V and topics for possible future work (A/CN.9/WG.V/WP.117, in particular paras. 7–11). Subsequent records indicate that the feasibility of developing a convention on international insolvency issues was discussed in an open-ended informal group established by interested delegations (see A/CN.9/803, para. 39 (a), A/CN.9/864, para. 88 and A/CN.9/870, para. 88). The Commission took note of that informal group's work at its sessions in 2014 and 2016 (*Official Records of the General Assembly, Sixty-ninth Session, Supplement No. 17* (A/69/17), paras. 152, 158 and 159; and ibid., *Seventy-first Session, Supplement No. 17* (A/71/17), para. 247).

[13] See a proposal by the International Insolvency Institute (III) on the choice of law in cross-border insolvency cases that was before the Working Group at its forty-fourth session (Vienna, 16–20 December 2013) (A/CN.9/WG.V/WP.117, paras. 12–16).

[14] A/CN.9/798, paras. 18, 19, 24 and 30.

[15] A/CN.9/WG.V/WP.117, paras. 13–16.

insolvency proceedings was prepared, in particular the suggested scope of *lex fori concursus* and a limited number of recommended exceptions thereto.

10. Parts of the Guide on the treatment of secured creditors[16] were in particular subject to thorough deliberations, including as regards law applicable to the creation, effectiveness, priority and enforcement of security rights in the case of insolvency (see further para. 23 below). They were prepared jointly with UNCITRAL Working Group VI (Security Interests) to ensure that UNCITRAL texts in the areas of insolvency law and security interests are coherent as regards treatment of secured creditors in insolvency.[17]

11. Since recommendations 30–34 and the commentary thereto were included in the Guide, UNCITRAL adopted several other texts in the area of insolvency law, including parts three and four of the Guide addressing, respectively, enterprise group insolvency and directors' obligations in the period approaching insolvency.[18] The Working Group also considered other developments in the area of insolvency law, in particular as regards payment and settlement systems and regulated financial markets (see para. 27 below), that informed the preparation of its possible future work programme.[19]

B. Law applicable to validity and effectiveness of rights and claims

Recommendation 30

Law applicable to validity and effectiveness of rights and claims

The law applicable to the validity and effectiveness of rights and claims existing at the time of the commencement of insolvency proceedings should be determined by the private international law rules of the State in which insolvency proceedings are commenced.

Accompanying commentary

80. Where insolvency proceedings involve parties or assets located in different States, complex questions may arise as to the law that will apply to questions of validity and effectiveness of rights in those assets or of other claims; and to the treatment of those assets and of the rights and claims of those foreign parties in the insolvency proceedings. In the case of such insolvency proceedings, the forum State will usually apply its private international law rules (or conflict of laws rules) to determine which law is applicable to the validity and effectiveness of a right or claim and to their treatment in the insolvency proceedings.

81. In a purely domestic setting, insolvency law does not "create" rights (personal or proprietary) or claims, but should respect the rights and claims that have been acquired against the debtor according to other applicable laws, that is civil, commercial or public law. Insolvency law concerns itself with determining the

[16] See e.g., recommendations 4, 49–53, 58–59, 65–67, 88 and 187–188 with accompanying commentary and also section E in chapter III of part two of the Guide. Annex I to the Guide lists most provisions of the Guide that address the treatment of secured creditors.

[17] See e.g., A/CN.9/535 – Report of Working Group V (Insolvency Law) and Working Group VI (Security Interests) on the work of their first joint session (Vienna, 16–17 December 2002) and A/CN.9/550 – Report of Working Group V (Insolvency Law) and Working Group VI (Security Interests) on the work of their second joint session (New York, 26 and 29 March 2004). The report of Working Group VI (Security Interests) on the work of its fifth session (New York, 22–25 March 2004) (A/CN.9/549, para. 34) notes that the Working Group found the principles applicable to the enforcement of security rights in the case of insolvency eventually included in the Guide to be generally acceptable. See also footnote 6 above in that respect.

[18] Whereas the UNCITRAL Model Law on Cross-Border Insolvency (MLCBI) is annexed to the Guide and specifically recommended for enactment in recommendation 5, the two recent ones are not. In addition, the Guide to Enactment of the MLCBI annexed to the Guide was replaced by the Guide to Enactment and Interpretation in 2013.

[19] See A/CN.9/798, para. 30.

relative position of each of those rights and claims once insolvency proceedings have commenced and, where appropriate, with establishing the restrictions and modifications to which they will be subject in insolvency proceedings in order to fulfil the collective aims of those proceedings. These limits and restrictions are "insolvency effects" because they arise from the commencement of insolvency proceedings against a debtor.

82. In the context of cross-border insolvency, it is essential to distinguish between the creation of rights and claims under the law designated as applicable law (whether domestic or foreign substantive law) in accordance with the conflict of laws rules of the forum and the insolvency effects on those rights and claims. Since, as noted, the insolvency law does not establish rights or claims, the issue of whether a given right or claim has been created, and the content of that right or claim, belongs to the realm of general conflict of laws rules. It is typical under general conflict of laws rules, for example, that the law governing the contract will determine if a contractual claim exists against the insolvent debtor and the amount of that claim; that the *lex rei sitae* will determine if a security interest in immovable assets has been created in favour of a specific creditor, and so on. In this sphere, each State will apply its own conflict of laws rules, including any international conventions in force. In the case of an insolvency proceeding, the forum State will usually apply its conflict of laws rules to determine which law governs the validity and effectiveness of a right or claim before considering the treatment of the right or claim in the insolvency proceedings. It is important to stress that the determination of validity and effectiveness is not an insolvency question, but a matter of other applicable law.

12. As noted in the commentary to recommendation 30, the recommendation establishes the rule for determining the law applicable to the validity and effectiveness of pre-commencement rights and claims.[20] It should thus be applicable also when such rights and claims become the basis for actions by an insolvency representative or other parties after commencement of insolvency proceedings.[21] In comparison, the validity and effectiveness of post-commencement rights and claims would fall outside the scope of the recommendation. The surveyed texts interpret the phrase "the law applicable" as excluding renvoi.[22]

C. Law applicable in insolvency proceedings: *lex fori concursus*

Recommendation 31

Law applicable in insolvency proceedings: lex fori concursus

The insolvency law of the State in which insolvency proceedings are commenced (*lex fori concursus*) should apply to all aspects of the commencement, conduct, administration and conclusion of those insolvency proceedings and their effects. These may include, for example:

(a) Identification of the debtors that may be subject to insolvency proceedings;

(b) Determination of when insolvency proceedings can be commenced and the type of proceeding that can be commenced, the party that can apply for commencement and whether the commencement criteria should differ depending upon the party applying for commencement;

[20] The same rule is found, for example, in article 8 of the Hague Convention on the Law Applicable to Certain Rights in Respect of Securities held with an Intermediary (concluded 5 July 2006) and article 94 of the UNCITRAL Model Law on Secured Transactions.

[21] Such interpretation is supported, for example, by ECJ, *NK v. BNP Paribas Fortis NV*, C-535/17, Judgment, 6 February 2019, para. 28 and the case law cited there that reaffirm that a distinction between insolvency and non-insolvency matters would not be the procedural context of which an action in question was part and not the timing of the taken action, but the legal basis thereof.

[22] See e.g., article 92 of the UNCITRAL Model Law on Secured Transactions; Global Rule 5; and para. 87 of the Report on the EU Convention.

(c) Constitution and scope of the insolvency estate;

(d) Protection and preservation of the insolvency estate;

(e) Use or disposal of assets;

(f) Proposal, approval, confirmation and implementation of a plan of reorganization;

(g) Avoidance of certain transactions that could be prejudicial to certain parties;

(h) Treatment of contracts;

(i) Set-off;

(j) Treatment of secured creditors;

(k) Rights and obligations of the debtor;

(l) Duties and functions of the insolvency representative;

(m) Functions of the creditors and creditor committee;

(n) Treatment of claims;

(o) Ranking of claims;

(p) Costs and expenses relating to the insolvency proceedings;

(q) Distribution of proceeds;

(r) Conclusion of the proceedings; and

(s) Discharge.

Accompanying commentary

83. Once a right or claim is determined to be valid and effective under the law designated as applicable by the conflict of laws rules of the forum, a second issue is the effect of insolvency proceedings on the right or claim – that is, whether it will be recognized and admitted in the insolvency proceedings and, if so, its relative position. This is an insolvency matter. From the conflict of laws point of view, the problem in this second phase lies in determining the law applicable to these insolvency effects. It is quite typical that the law of the State in which insolvency proceedings are commenced, the *lex fori concursus*, will govern the commencement, conduct, administration and conclusion of those proceedings. This would generally include, for example, determining the debtors that may be subject to the insolvency law; the parties that may apply for commencement of insolvency proceedings and the eligibility tests to be met; the effects of commencement, including the scope of application of a stay; the organization of the administration of the estate; the powers and functions of the participants; rules on admissibility of claims; priority and ranking of claims; and rules on distribution. Accordingly, this law generally will govern the insolvency effects over rights and claims validly acquired under foreign law, for example, whether the right or claim, given its nature and conditions, is admissible in the insolvency of the debtor and how it will be ranked.

84. Problems may arise when the law governing the ranking of a claim and the applicable law other than the insolvency law governing the claim are different. The categories of privileges and priorities that exist and the ranking of claims is always established by the *lex fori concursus*. Normally, when establishing these categories and ranking, the insolvency law of a State takes into account the existence of these claims under the domestic law of the State. However, the claim of a creditor may be constituted in accordance with a foreign law. In that case, it is necessary to determine which claims created under foreign law qualify as equivalent to domestic law claims conferring certain privileges or priorities. In other words, it is necessary to examine whether the kind of claim created under foreign law is “equivalent” to the kind of claim upon which the *lex fori concursus* confers a special status in insolvency proceedings. The test to apply is whether or not both claims, given their essential

content and their function, correspond to each other to the extent that they can be considered as "functionally interchangeable". If the answer is in the affirmative, the claims should be considered equivalent and receive the same treatment in insolvency proceedings. In the event that equivalence cannot be established, the claim would generally be treated as an ordinary claim.

1. Chapeau, first sentence

13. The first sentence of the recommendation states that the "insolvency law of the State in which insolvency proceedings are commenced (*lex fori concursus*) should apply …". The surveyed texts, in the same context, state that the "law applicable to insolvency proceedings and their effects shall determine the conditions for the opening of those proceedings, their conduct and their closure", or they contain similar broader references.[23] Some of them clarify that such law determines the effects of the insolvency proceedings, both procedural and substantive, on the person and legal relations concerned.[24]

14. There are different views on the meaning of the word "law" in this context. Some consider that reference should not be limited to the insolvency law.[25] Others consider that reference is to the insolvency law, both procedural and substantive, as "the whole body of rules providing for specific effects of insolvency proceedings in order to achieve the tasks and the goals of such proceedings as defined by the *lex concursus*".[26]

15. The Guide refers to the law other than the insolvency law in several contexts of relevance to recommendation 31. For example, recommendation 66 addressing security for post-commencement finance, opens with the words "the law" with an accompanying footnote explaining that the rule contained in that recommendation may be found in a law other than insolvency law, in which case the insolvency law should note the existence of the provision. Recommendations in part four of the Guide addressing directors' obligations in the period approaching insolvency refer to the law relating to insolvency and the commentary explains reasons for the use of that phrase.[27] References to the law other than insolvency law are found also, for example, in the commentary on joint assets,[28] priority or privileged claims[29] and sale of assets free and clear of interests.[30]

16. Different views also exist on whether reference to the "law" includes rules of private international law. The Reporters' notes to Global Rule 12 state that "law" in principle means a certain State's substantive and procedural law, including its soft law, but excluding its rules of private international law. A similar statement is found in other commentaries.[31] Another view is that *lex fori concursus* does not exclude choice of law rules of the State of the opening of the insolvency proceedings.[32] Where such rules refer to the law of another State, it is generally held that they refer to the substantive law of that State, not its private international law rules (i.e., renvoi is excluded).[33] (On that point, see further para. 19 below.)

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[23] See e.g., article 7 of the EIR recast and Global Rule 12. Article 1 of the Nordic Convention refers in this context to the law of the country in which bankruptcy takes place.
[24] See para. 90 of the Report on the EU Convention and recital 66 of the EIR recast.
[25] See the Reporters' notes to Global Rule 12.
[26] See Brinkmann, "European Insolvency Regulation. Article-by Article Commentary", p. 87.
[27] See chapter I. Background, para. 11 and footnote 6.
[28] See paras. 20 and 21 in chapter II of part two of the Guide.
[29] See paras. 67–74 of chapter V of the Guide.
[30] See paras. 85–86 of chapter II of part two of the Guide.
[31] See e.g., para. 87 of the Report on the EU Convention.
[32] See Brinkmann, "European Insolvency Regulation. Article-by Article Commentary", pp. 88–90.
[33] See Global Rule 5.

2. Chapeau, second sentence: illustrative list of items for *lex fori concursus*

17. Recommendation 31 contains an illustrative list of items that fall under *lex fori concursus* as the words in the second sentence "These may include, for example" indicate. Some surveyed texts include the minimum mandatory list[34] while others do not include any list of items.[35]

18. It may be considered that some items listed in recommendation 31, such as (a), (b), (k), (l), (m), (p) and (r), fall under the procedural insolvency law and must therefore fall under *lex fori concursus* in accordance with "the universally accepted choice of law rule that courts apply their own procedural law as part of the *lex fori*. In particular, it is generally agreed that enforcement proceedings are governed by *lex fori executionis*. What is true for individual enforcement must also apply to insolvency proceedings as a collective means of private enforcement."[36]

19. Other items may fall under substantive law. Some argue that, as such, they may be determined according to specific choice of law rules referring to external connecting factors.[37] Another view is that the substantive effects referred to the competence of the law of the State of the opening of insolvency proceedings are those typical of insolvency law, i.e., effects which are necessary for the insolvency proceeding to fulfil its aims. To this extent, the law of the State of the opening may displace the law normally applicable under the common pre-insolvency rules on conflict of laws to the act concerned. This happens, for instance, with avoidance of acts detrimental to the general body of creditors even if that act is governed, under the general rules on conflict of laws, by the law of a different State.[38]

3. Issues raised by the listed items

20. Lists of items falling under *lex fori concursus* found in the surveyed texts are different from the list contained in recommendation 31. Some differences are not significant. They may arise, for example, because of a different grouping of items or different terminology used.

21. The list in recommendation 31 should be read with other provisions of the Guide. For example, item (d) referring to the protection and preservation of the insolvency estate encompasses, under chapter II of the Guide, the stay upon commencement of the proceeding. The stay of proceedings is defined in the Glossary as a "measure that prevents the commencement, or suspends the continuation, of judicial, administrative or other individual actions concerning the debtor's assets, rights, obligations or liabilities, including actions to make security interests effective against third parties or to enforce a security interest; and prevents execution against the assets of the insolvency estate, the termination of a contract with the debtor, and the transfer, encumbrance or other disposition of any assets or rights of the insolvency estate." As such, item (d) encompasses a number of aspects that may be listed separately under *lex fori concursus* in other texts. The same applies to some other items in the list whose scope is explained by other provisions of the Guide (e.g., use and disposal of assets,[39] treatment of contracts[40] and treatment of claims[41]).

22. Other differences in listing of items in surveyed texts as compared to recommendation 31 are more substantive, for example, omission of item (f) (proposal,

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[34] See e.g., article 7.2 of the EIR recast stating: "In particular, it shall determine the following:" For a case law explaining how the list should be read, see e.g., ECJ, judgment of 9 November 2016, *ENEFI*, C-212/15.

[35] See e.g., Global Rule 12.

[36] See Brinkmann, "European Insolvency Regulation. Article-by Article Commentary", p. 88.

[37] Ibid.

[38] See para. 90 of the report on the EU Convention.

[39] See section C of chapter II in part two of the Guide.

[40] See section E of chapter II in part two of the Guide.

[41] See section A of chapter V in part two of the Guide.

approval, confirmation and implementation[42] of a plan of reorganization) or (j) (treatment of secured creditors). The omission of the latter item may be explained by the exclusion in some surveyed texts of pre-existing rights *in rem*[43] from the effects of the opening of insolvency proceedings,[44] other than avoidance.[45] In some texts, such exclusion is subject to a safeguard aimed at preventing an abusive exploitation of "asset havens".[46]

23. This practice with respect to rights *in rem* is acknowledged in paragraph 88 of the commentary to recommendations 30–34. However, a proposal to include an exception to *lex fori concursus* for rights *in rem* in the Guide did not receive sufficient support when the Guide was prepared.[47] It was agreed at that time that the commencement of insolvency proceedings should not displace the general, pre-insolvency conflict-of-laws rules applicable to the creation and effectiveness of a security right against third parties. It was also agreed that commencement of insolvency proceedings should not displace the law applicable to priority of security rights, except to the extent explicitly provided in insolvency law. In addition, it was agreed that commencement could displace the rules applicable to the enforcement of security rights since enforcement should be subject to the insolvency law of the State in which the insolvency proceedings were commenced.[48]

24. Paragraph 88 of the commentary also acknowledges that rights of set-off may be subject to law other than the law of the forum, for reasons related to the parties' expectations, especially if they engage in regular dealings with each other. At the same time, paragraph 91 of the commentary states that the rules of set-off of the forum should be applied to claims on the basis that, in insolvency, rights of set-off are closely related to the proof and quantification of claims and policies governing the equal treatment of creditors. Since these are questions regulated by the law of the forum, the rights of set-off should be similarly regulated. Some surveyed texts provide that the law applicable to the debtor's claim at the time when the right to set-off was created prevails if it allows set-off while *lex fori concursus* does not.[49] This rule is made applicable only to a right to set-off arising in respect of mutual claims incurred prior to the opening of insolvency proceedings[50] and, in some surveyed texts, it is subject to a safeguard that it may be disapplied if the parties' choice of the law applicable to the debtor's claim is unreasonable.[51]

25. With respect to avoidance (item (g) in the list), paragraphs 89 and 90 of the commentary discuss different approaches to determining the law governing the avoidance of transactions and policies underlying those approaches. Those matters were also discussed at the Colloquium (see paras. 26 and 27 of the Colloquium report). One of the approaches described on those occasions is found in the surveyed texts that provide for protection of an act from avoidance if it is subject to the law other than *lex fori concursus* and that other law does not allow any means of

[42] The term "implementation of a plan of reorganization" in that item, if read broader than the "content of the plan", may raise questions since the implementation of the plan might be left in some cases to contract law and thus party autonomy to choose applicable law.

[43] The characterization of a right as a right *in rem* is left in those texts to the national law that governs these rights *in rem*, which in general will be the *lex rei sitae,* but the rights recorded in a public register and enforceable against third parties, are usually considered to be a right *in rem.* For examples of rights *in rem*, see article 8 of the EIR recast and the comment to Global Rule 15.

[44] See e.g., recitals 68 and 69 and article 8 of the EIR recast; article 50 of the Montevideo Treaty (1940); article 420 of the Bustamante Code; articles 5 and 7 of the Nordic Convention; and Global Rule 15.

[45] See e.g., article 8.4 of the EIR recast.

[46] See e.g., Global Rule 16.

[47] A/CN.9/551, para. 31. See also recommendations 3 and 4 of the Guide related to that discussion.

[48] See A/CN.9/549, para. 34.

[49] See e.g., article 9 of the EIR recast; and Global Rule 17 to be read together with Global Rule 21.

[50] See e.g., the comment and the Reporters' notes to Global Rules 17 and 18.

[51] See e.g., Global Rule 18.

challenging that act in the relevant case.[52] A safeguard aimed to prevent the abusive choice of law in such cases is also found.[53]

26. Cross-border recognition of effects of *lex fori concursus* as regards some items listed in recommendation 31, such as treatment and ranking of claims and discharge of debts, raise additional issues under certain circumstances.[54]

D. Exceptions to *lex fori concursus*

1. Payment or settlement system or regulated financial market

Recommendation 32

Notwithstanding recommendation 31, the effects of insolvency proceedings on the rights and obligations of the participants in a payment or settlement system or in a regulated financial market should be governed solely by the law applicable to that system or market.

Accompanying commentary

86. Exceptions to the application of the *lex fori concursus* respond, in general, to certain social policy considerations. Some laws focus, for example, on supporting commercial certainty and reducing risk for the parties engaged in commercial transactions. The parties to a transaction shape their relationships against the background of a specific legal environment, which includes consideration of the degree to which their rights will be protected in the event of the insolvency of the debtor, the most typical risk faced by any creditor. The application of the law under which the right or claim in question was created may be, in general, less costly for the creditor to learn, more predictable in terms of insolvency effects and more difficult for the debtor to manipulate ex post than the application of the law of the debtor's centre of main interests or domicile. On that basis, it may be argued that it would be reasonable, under certain circumstances, to permit and protect reliance by the parties on the law under which the right or claim was created. A key example relates to payment or settlement systems and regulated financial markets, which many insolvency laws recognize as requiring an exception to the application of the *lex fori concursus*. By applying the law that is applicable to the system or the regulated market, alteration of the mechanisms for payment and settlement in the event of insolvency of a participant can be avoided, thus protecting general certainty and confidence in the system or market and avoiding systemic risk.

27. Unlike other recommendations of the Guide, recommendation 32 contains strong instructive language ("should" and "solely"). It should be read together with recommendations 101 to 107 of the Guide and the commentary thereto addressing financial contracts and netting. They, among other things: (a) provide for exceptions of financial contracts from a stay, including as regards enforcement of contract termination clauses and security interests; (b) exempt routine pre-commencement transfers from avoidance; and (c) recommend recognizing and protecting the finality of the payment and settlement system operations upon insolvency of a participant in the system. In that respect, the Working Group may wish to recall that, at its forty-fourth session, in 2013, it was agreed that it was necessary to update that part of the Guide.[55] The Colloquium report (see paras. 24, 25 and 47 (d)) highlighted the

[52] See e.g., articles 7.2 (m) and 16 of the EIR recast (and also articles 8.4, 9.2, 10.3 and 12.2).

[53] See e.g., Global Rule 23.

[54] See e.g., article 20 of the EIR recast; the rule found in some common law jurisdictions that a debt can only be compromised under the law applicable to the debt, unless the creditor submitted to the foreign jurisdiction; and materials of session 2 of the Fourth UNCITRAL International Insolvency Law Colloquium, 16–18 December 2013, Vienna (https://uncitral.un.org/en/colloquia/insolvency/fourth_uncitral_international_insolvency_law_colloquium) highlighting issues arising with cross-border recognition of discharge.

[55] See A/CN.9/798, paras. 26 and 30. Reference in that respect was made to the Unidroit Principles on the Operation of Close-Out Netting Provisions. See also Principle C10.4 of the World Bank

need to consider in the context of this project issues arising from the digitalization of financial markets and transactions.

28. In one surveyed text, the same exception to *lex fori concursus* is extended to actions for voidness, voidability or unenforceability of payments or transactions made in those systems or markets.[56]

2. Labour contracts

Recommendation 33

Notwithstanding recommendation 31, the effects of insolvency proceedings on rejection, continuation and modification of labour contracts may be governed by the law applicable to the contract.

Accompanying commentary

87. Some laws adopt exceptions to preserve certain rights or interests specially protected by the law of a State from the uncertainties or inconsistencies that may result from the application of the insolvency effects of a foreign *lex fori concursus*. For example, with respect to labour contracts, special (often mandatory) protections may be afforded in terms of a financial safety net for workers or restrictions on the rejection or modification of those contracts in insolvency. The rationale of such provisions lies in protecting the reasonable expectations of employees with respect to their contract of employment, recognizing that workers may have a relatively weaker bargaining position than their employer, and in ensuring non-discrimination among workers working in the same State, whether they are employed by a local or by a foreign employer. In some States, such protections will apply only to individual employment contracts, while in others these provisions also will apply to collective bargaining agreements.

29. Unlike recommendation 32, recommendation 33 is permissive (the word "may" is used). The drafting history of that recommendation indicates that its inclusion in the Guide, even with such a permissive wording, had raised concerns. One concern was that, as a general principle, employees of the debtor working in the forum State should be treated according to the law of that State and that the words after "labour contracts" be amended to read "may be limited to employees in the State in which insolvency proceedings commence". Another concern was that the recommendation should be revised to provide that only some contracts might be subject to another law or that the recommendation should only be relevant to labour contracts that were governed by a law other than the law of the forum. A further concern was that, as currently drafted, the recommendation might give the impression that the Working Group favoured the inclusion of such an exception in an insolvency law and it should therefore be removed to the commentary. A different view was that since the provision was merely permissive and that in some regions of the world it was quite common for businesses to have employees working in different jurisdictions under different labour contracts, the recommendation should be maintained. It was noted that the absence of such an exclusion from the law of the forum might have public policy implications that had the potential to cause uncertainty and impede the conduct of insolvency proceedings.[57]

30. An unconditional exception to *lex fori concursus* for labour contracts is found in some surveyed texts ("shall be governed solely").[58] The commentary to them clarifies that reference to the law of the State applicable to the contract of employment includes the insolvency law of that State.[59] At the same time, it is emphasized that *lex fori concursus* would remain applicable to submission, verification, admission,

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Principles for Effective Insolvency and Creditor/Debtor regime that deviates from recommendations 101–107 of the Guide.

[56] See e.g., article 12 of the EIR recast.

[57] A/CN.9/551, para. 30.

[58] See e.g., article 13 of the EIR recast and Global Rule 20.

[59] See para. 128 of the Report on the EU Convention.

ranking and avoidance of employment claims.[60] An exception to that would be where an undertaking to prevent the opening of a concurrent proceeding has been given.[61]

3. Other possible exceptions to the *lex fori concursus*

Recommendation 34

Any exceptions additional to recommendations 32 and 33 should be limited in number and be clearly set forth or noted in the insolvency law.

Accompanying commentary

80. … While insolvency proceedings may typically be governed by the law of the State in which those proceedings are commenced (the *lex fori concursus*), many States have adopted exceptions to the application of that law, which vary both in number and scope. The diversity in the number and scope of such exceptions may create uncertainty and unpredictability for parties involved in cross-border insolvency proceedings. By specifically addressing, in a transparent and predictable manner, issues of applicable law an insolvency law can assist in providing certainty with respect to the effects of insolvency proceedings on the rights and claims of parties affected by those proceedings.

…

85. To determine the insolvency effects on valid and effective rights and claims, some laws adopt exceptions to the application of the *lex fori concursus*. The purpose of the exception is not to change the law applicable to the question of validity and enforceability (which continues to be governed by the general conflict of laws rules of the forum), but to change the law applicable to the insolvency effects. Instead of applying the *lex fori concursus*, the insolvency effects may be governed, for example, by the same law applicable to the question of validity and effectiveness. For instance, the insolvency effects over a right to set-off may be determined not by the *lex fori concursus*, but by the law applicable to the right to set-off. Other examples of exceptions to the application of the law of the forum that have been adopted by different insolvency laws address the law applicable to payment systems, labour contracts, avoidance provisions and proprietary rights.

…

91. It is critical that policy considerations that form the basis of an exception to the application of the *lex fori concursus* be weighed against other considerations that are central to insolvency proceedings, in particular the goal of maximizing the value of the insolvency estate for the benefit of all creditors, rather than specific individual creditors, and treating all similarly situated creditors equally. The law of the forum will be designed to support the specific goals of insolvency in that State and will provide certainty for the insolvency representative in performing many of its functions with respect to the insolvency proceedings, including avoidance of transactions, treatment of contracts, treatment of claims and so on. Its application in insolvency proceedings may avoid potentially costly and extensive litigation to determine issues of applicable law for purposes of insolvency effects and the validity and effectiveness of rights or claims given the insolvency effects under the law of the forum. Thus, in many circumstances the application of the *lex fori concursus* for insolvency effects may reduce costs and delays and therefore maximize the value of the insolvency estate for the benefit of all creditors. Furthermore, the application of an exception to the *lex fori concursus* for insolvency effects may result in disparate treatment of the insolvency effects on similarly situated creditors merely because different applicable law governs their rights and claims. …

[60] Ibid. See also, recital 72 of the EIR recast and the comment and the Reporters' notes to Global Rules 19–21.

[61] See recital 72 and article 36 of the EIR recast.

31. Some surveyed texts provide for additional exceptions to *lex fori concursus*,[62] including as regards acts concluded after the opening of insolvency proceedings.[63] The drafting history of the recommendations 30–34 indicates that there was some hesitation to include in the Guide exceptions to *lex fori concursus* additional to those listed in recommendations 32 and 33 (concern was expressed at that time that "the Guide should not be seen to encourage the proliferation of exceptions"[64]).

IV. Issues for consideration by the Working Group

32. The Working Group is invited to consider the direction that the work on the topic should take and its scope, in particular, whether the work should be limited to updating the relevant section of the Guide or whether it should lead to preparing a separate instrument that would supersede or supplement the Guide in that respect, as it was done for enterprise group insolvency. The extent of amendments to the existing provisions in the Guide would depend on the choice made on that aspect. Regardless of that choice, the Working Group may wish to consider the desirability of taking the recommended step-by-step approach (see para. 2 above).

33. If such approach is taken, the Working Group may wish to give directions to the secretariat first as regards issues raised in chapter III of this note and other points arising therefrom, for example:

(a) Whether issues addressed in recommendation 30 require further elaboration;

(b) Whether additional items should be listed under *lex fori concursus*, such as pursuit of actions against directors in the light of the subsequent addition of part four to the Guide;

(c) Whether the list in recommendation 31 should be amended otherwise;

(d) Whether the approach taken to drafting recommendations 32 and 33 when the Guide was prepared is still valid;

(e) Whether additional exceptions to *lex fori concursus* would be required;

(f) Whether applicable law rules may raise distinct issues in the context of reorganization as opposed to liquidation;[65]

(g) Whether a public policy exception that would disallow the application of a foreign law, currently not found in the Guide in the context of recommendations 30–34, should be addressed;[66]

(h) Whether any special treatment should be accorded to digital assets (see para. 47 (d) of the Colloquium report).[67]

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[62] E.g., contracts relating to immovable property (article 11 of the EIR recast), effects on rights subject to registration (article 14 of the EIR recast) and pending lawsuits and arbitral proceedings (article 18 of the EIR recast).

[63] See article 17 of the EIR recast on protection of third-party purchasers.

[64] A/CN.9/551, para. 31.

[65] During expert group consultations held by the secretariat, the secretariat was informed about a proposal in one jurisdiction to provide in legislation for a separate set of applicable law rules for reorganization. A negative impact of an exception to *lex fori concursus* for labour contracts on reorganization whose goal is to achieve the universal scope was in particular highlighted in that context.

[66] Such exception is found in other UNCITRAL texts, including in the area of cross-border insolvency, but recommended to be interpreted restrictively and invoked under exceptional circumstances concerning matters of fundamental importance for the State. See e.g., para. 104 of the Guide to Enactment and Interpretation of the Model Law on Cross-Border Insolvency.

[67] In that context, the Working Group may wish to note the work on digital assets in other fora, e.g., Unidroit (www.unidroit.org/work-in-progress/digital-assets-and-private-law). However, consultations held by the secretariat on the matter do not indicate a need for an exception to *lex fori concursus* specifically designed for digital assets.

34. At subsequent stages of the project, the interaction of *lex fori concursus* of concurrent proceedings may need to be considered with reference to relevant provisions of UNCITRAL insolvency model laws (see in that respect paras. 10–14 of the Colloquium report and para. 8 above).[68] At the Colloquium, difficulties with the application of *lex fori concursus* in the enterprise group context were particularly highlighted (see para. 38 of the Colloquium report).[69]

[68] Several provisions of the MLCBI contain references to applicable law, either applicable foreign law or the law of the enacting State (see e.g., articles 5, 13.2, 14.3.c, 21.3, 23.2, 24 and 28) and establish the pre-eminence of the foreign main proceeding over the foreign non-main proceeding (see e.g., article 19.4 of the MLCBI) and of the local insolvency proceeding over the foreign insolvency proceeding (see e.g., article 29 of the MLCBI).

[69] As was noted at the Colloquium (see para. 14 of the Colloquium report), some provisions of the UNCITRAL Model Law on Enterprise Group Insolvency (MLEGI) imply deference to the *lex fori concursus* of the jurisdiction of the main proceeding where the group planning proceeding commenced. In addition, MLEGI touches upon applicable law when it addresses undertakings on the treatment of foreign claims (articles 28 and 30) although it does not refer in that context to, for example, the law applicable to the form of the undertaking, the law applicable to the approval of the undertaking (rules on majority required, voting, etc.) and the law applicable to the distribution of proceeds from the realization of the local assets, rights of the creditors in relation to those assets and ranking of creditors' claims. In comparison, see article 36 of the EIR recast.