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Applicable law in insolvency proceedings

Note by the Secretariat

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I. Introduction

1. The provisional agenda of the sixty-second session of the Working Group (A/CN.9/WG.V/WP.185) provides background information about the project on applicable law in insolvency proceedings referred to the Working Group by the Commission at its fifty-fourth session, in 2021.[1] At its sixty-first session, the Working Group requested the secretariat to revise draft legislative provisions and commentary and consolidate them in a single document for consideration by the Working Group at its next session. The understanding was that, for the time being, a model law would remain a working assumption.[2] The Working Group is still to agree on the final form of the instrument and on how the final text will interact with existing UNCITRAL texts in the area of insolvency law.

2. The secretariat sets out revised draft legislative provisions and commentary in chapter II below. The footnotes in bold accompanying the draft legislative provisions and commentary indicate the source for revisions. Other footnotes accompanying those materials intend to stay in the final text as appropriate depending on its final form. Issues for consideration by the Working Group are set out before the draft materials. Provisionally, the secretariat retains references to the legislative provisions on the understanding that they will be replaced in due course by references appropriate for the agreed form of the instrument.

II. Draft legislative provisions with accompanying commentary

A. Purpose and objectives

3. The Working Group may wish to consider the draft legislative provision and commentary revised to reflect deliberations at the sixty-first session of the Working Group. In particular, the draft commentary was expanded with the explanation of the term “abusive forum shopping” included in the draft legislative provision. As agreed by the Working Group, the word “abusive” appears in square brackets in the draft legislative provision for further consideration by the Working Group.[3] Furthermore, an additional text was included at the end of the draft commentary that explains the scope of the legislative provisions. It reflects the agreement reached by the Working Group on that matter at its sixty-first session (see the draft legislative provision on the scope of application of the legislative provisions in section B below). In the light of that agreement, changes were made throughout the draft text to convey better the narrow scope of the project.

1. Draft legislative provision

Preamble

The purpose of these legislative provisions is to provide clear rules for determining the law that governs the commencement, conduct, administration and closure of insolvency proceedings and their effects (the “governing law”), including in concurrent proceedings with respect to a single debtor or members of an enterprise group, so as to achieve the key objectives of effective and efficient insolvency proceedings,[4] including legal certainty and predictability,[5] and to reduce the risk of

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

[2] A/CN.9/1126, para. 80.

[3] Ibid., para. 58.

[4] **The Working Group agreed to replace “insolvency law” with “insolvency proceedings”. Ibid., para. 57 (b).**

[5] **The Working Group agreed to add references to legal certainty and predictability. Ibid., para. 57 (a).**

[abusive][6] forum shopping and other acts detrimental to creditors and other parties in interest.

2. Draft commentary

1. The legislative provisions provide rules for determining the law that governs the commencement, conduct, administration and closure of insolvency proceedings and their effects (the "governing law"). They aim to establish clarity in that respect especially for insolvency proceedings involving assets or parties located in different jurisdictions.

2. Achieving clarity on those matters is desirable for the following reasons. Criteria for determining the law governing procedural aspects of insolvency proceedings, such as commencement, conduct, administration and closure of insolvency proceedings, do not differ much across jurisdictions – the law of the place in which insolvency proceedings are commenced (the lex fori concursus) governs those issues. However, different criteria are used for determining the law governing the effects of insolvency proceedings on certain types of assets, rights and claims (e.g. rights in rem, set-off rights). Exceptions to the application of the lex fori concursus in those cases are found in some jurisdictions, while in other jurisdictions the law may be silent on those issues or address them only partly. The diversity in the number and scope of those exceptions, or the absence of any rules on those matters, with the result that courts are left to determine the governing law on a case-by-case basis, creates uncertainty and unpredictability.

3. Ascertaining the governing law becomes more complicated when several proceedings take place for the same debtor or members of an enterprise group concurrently, each subject to its own rules for determining the governing law. Concurrent proceedings may be any combination of a foreign main proceeding (one of which may become the planning proceeding under the UNCITRAL Model Law on Enterprise Group Insolvency[7] (MLEGI)), a foreign non-main proceeding and an insolvency proceeding that is neither a foreign main nor a foreign non-main proceeding opened at the location of the debtor's assets (see article 28 of the UNCITRAL Model Law on Cross-Border Insolvency[8] (MLCBI)). Some of those proceedings may become the subject of a recognition proceeding in other States that may or may not open local ancillary insolvency proceedings. The recognizing State may apply its own law to issues such as the scope of the automatic relief resulting from the recognition of a foreign main proceeding (article 20 (2) of MLCBI), discretionary relief (articles 19 (1) (c) and 21 (1) (g) of MLCBI), additional assistance (article 7 of MLCBI) and allocation of assets between or among different proceedings (articles 21 (3), 23 (2), 28 and 29 (c) of MLCBI). The recognizing State may or may not recognize the effects of the foreign lex fori concursus (of main, non-main or other insolvency proceedings). Those concurrent or parallel proceedings necessitate clarification of the governing law or the coordination of the application of several governing laws.

4. Earlier UNCITRAL insolvency texts do not address those matters and they facilitate cross-border recognition and enforcement of effects of the lex fori concursus of the foreign main proceeding only to some extent.

5. The main purpose of the legislative provisions is to fill in those gaps by offering simple and clear rules to address the governing law that States can incorporate in their

[6] **The Working Group requested to include the word "abusive" in square backets in this legislative provision, for further consideration. Ibid., para. 58.**

[7] United Nations publication, Sales No. E.20.V.3. UNCITRAL Model Law on Enterprise Group Insolvency with Guide to Enactment (2019) | United Nations Commission On International Trade Law.

[8] United Nations publication, Sales No. E.14.V.2. Available at UNCITRAL Model Law on Cross-Border Insolvency (1997) | United Nations Commission On International Trade Law.

domestic law. The legislative provisions do so by: (a) establishing a general rule that the law of the State of the opening of insolvency proceedings (the lex fori concursus) governs all aspects of the commencement, conduct, administration and closure of insolvency proceedings and their effects on persons, rights, claims and proceedings; (b) explaining the meaning and scope of that law; (c) providing for a limited number of exceptions to that rule; (d) delineating the scope of each exception and specifying when each of them is applicable; [and (e) establishing rules for determining the governing law, or coordinating the application of several governing laws, in concurrent proceedings with respect to a single debtor or members of an enterprise group].

6. Adherence to the framework suggested in the legislative provisions is expected to help to reduce divergences and fill in gaps left by fragmented or incomplete rules on the matters addressed in the legislative provisions. This in turn is expected to enhance: (a) certainty and predictability of outcomes of insolvency proceedings on the rights and claims of parties affected by those proceedings; (b) efficiency and effectiveness of insolvency proceedings through reduction of complexities and costs; (c) coordination of insolvency proceedings with cross-border aspects; and (d) trade and investment.

7. In addition, by adhering to the legislative provisions, States may reduce risks of [abusive][9] forum shopping and other acts detrimental to creditors and other parties in interest. What would be considered "abusive" would be determined by courts on a case-by-case basis. Identifying the optimum jurisdiction for a certain transaction or actions, including restructuring or reorganization, and taking measures so that the law of that jurisdiction is applied are generally acceptable across many jurisdictions. However, the choices made for the purpose of obtaining a more favourable legal position to the detriment of the general body of creditors or for other improper purposes are usually considered abusive. They would include taking advantage of the hospitable laws to shelter assets from the effects of the insolvency law to which either or both of the parties are immediately or prospectively subject or evading otherwise obligations or liabilities, including by frustrating the enforcement of a judgment.

8. The legislative provisions aim to achieve an appropriate balance between competing considerations that may be involved in insolvency proceedings. For example, the consideration of efficiency may favour that the court in the State of the opening of insolvency proceedings applies the lex fori concursus to all issues arising in the insolvency proceedings because the court is best positioned to articulate and apply its own law; where the court applies a foreign law, it may face the need to learn about the content and interpretation of that other law and deal with foreign legal categories that may be unknown to its legal system.[10] Other considerations, for example with respect to labour contracts and relationships, may outweigh the consideration of efficiency and require the application of the foreign law.

9. The scope of the legislative provisions is limited to the governing law issues and does not extend to the rules for determining the law applicable to the validity and effectiveness of rights or claims existing at the time of the commencement of insolvency proceedings. That law remains to be determined by the private international law (conflict-of-laws) rules (henceforth referred to as "PIL" or "PIL rules") of the State in which insolvency proceedings are commenced or of the other forum State where insolvency-related proceedings may be brought (e.g. adjudication of claims or avoidance actions).[11] Insolvency proceedings do not displace those rules but they may produce effects on the valid and effective pre-commencement rights, for example, by suspending or terminating: the right to commence an arbitral

[9] **The Working Group requested to include the word "abusive" in square backets in the draft legislative provision and explain its intended meaning in the draft commentary, which should allow the Working Group to decide at its next session whether the word should be retained (A/CN.9/1126, para. 58).**

[10] **Redrafted further to the comments made in the Working Group (ibid., para. 59).**

[11] **Ibid., para. 60.**

proceeding under an arbitration agreement concluded before the commencement of insolvency proceedings; the right of a creditor to offset its claims against the debtor; rights arising from transactions that were avoided in insolvency proceedings; and the rights of enforcement.

B. Scope of application of the legislative provisions

4. The Working Group may wish to consider the draft legislative provision and commentary revised to reflect deliberations in the Working Group at its sixty-first session.[12] It may in particular consider whether the text appearing in square brackets in paragraph 2 should stay.

1. Draft legislative provision

Scope of application

1. The legislative provisions provide rules for determining the governing law.

2. The legislative provisions do not provide rules for determining the law applicable to the validity and effectiveness of rights and claims existing at the time of the commencement of insolvency proceedings. [The law applicable to the validity and effectiveness of rights and claims existing at the time of the commencement of insolvency proceedings shall be determined by [*identify the private international law rules of the enacting State*]. Except as otherwise provided in these legislative provisions, insolvency proceedings shall not displace those rules.][13]

3. The legislative provisions do not apply to a proceeding concerning [*designate any types of entities, such as banks or insurance companies, that are subject to a special insolvency regime in this State and that this State wishes to exclude from the application of the legislative provisions*].[14]

2. Draft commentary

General

1. The scope of application of the legislative provisions is linked to the notions of "insolvency proceedings"[15] and "commencement of insolvency proceedings".[16] UNCITRAL insolvency texts set out a cumulative list of requisites that a proceeding must meet in order to be considered an "insolvency proceeding": (a) collective proceeding (judicial or administrative);[17] (b) pursuant to a law relating to insolvency (which includes company law);[18] (c) under control or supervision by a court (which includes the debtor-in-possession);[19] (d) with respect to a debtor (natural or legal

[12] **Ibid., paras. 60–62.**
[13] **Redrafted further to the views expressed in the Working Group (ibid., para. 60).**
[14] **Added further to the views expressed in the Working Group (ibid., para. 61).**
[15] The Glossary in the UNCITRAL Legislative Guide on Insolvency Law (the "Guide" and the "Glossary"), terms (s) and (u), to be read together and also with the explanation provided in part one, para. 2; the Guide to Enactment of the UNCITRAL Model Law on Recognition and Enforcement of Insolvency-Related Judgments (MLIJ) (GE), paras. 22, 48 and 49; and the Guide to Enactment and Interpretation of MLCBI (GEI), paras. 48–51 and 65–80.
[16] Recommendations 14–29 of the Guide. "Commencement of [insolvency] proceedings": the effective date of insolvency proceedings whether established by statute or a judicial decision (the Glossary, term (h)).
[17] GEI, paras. 69–72.
[18] GEI, para. 73.
[19] Recommendation 112 of the Guide, and GEI, paras. 71, 74–76, and 86.

person) that is in severe financial distress or insolvent;[20] and (e) with the goal of liquidating or reorganizing that debtor as a commercial entity.[21]

2. "Insolvency proceedings" under UNCITRAL insolvency texts encompass: (a) "liquidation", defined as proceedings to sell and dispose of assets for distribution to creditors in accordance with the insolvency law;[22] (b) "reorganization", defined as the process by which the financial well-being and viability of a debtor's business can be restored and the business can continue to operate, using various means possibly including debt forgiveness, debt rescheduling, debt-equity conversions and sale of the business (or part of it) as a going concern;[23] (c) "expedited reorganization proceedings" that combine voluntary restructuring negotiations and acceptance of a plan with an expedited procedure conducted under the insolvency law for court confirmation of that plan;[24] (d) simplified insolvency proceedings;[25] and (e) interim, restructuring and any other proceeding that the court may ascertain on a case-by-case basis as meeting the cumulative list of the requisites set out above.[26]

3. Any other proceedings that do not meet the requisites set out above would fall outside the scope of application of the legislative provisions. For example, a debt collection proceeding or receivership initiated by a particular creditor or group of creditors or gathering up assets in winding-up or conservation proceedings that do not also include provision for addressing the claims of other creditors are excluded.[27] A judicial or administrative proceeding for a solvent entity that does not seek to restructure its financial affairs but rather to dissolve its legal status is also excluded.[28] Financial adjustment measures or arrangements undertaken between the debtor and some of its creditors on a purely contractual basis concerning some debt, where the negotiations do not lead to the commencement of an insolvency proceeding conducted under the insolvency law, will also be outside the scope of the legislative provisions.[29] In addition, proceedings that are designed solely to prevent dissipation and waste of assets, rather than to liquidate or reorganize the insolvency estate, as well as proceedings designed to prevent detriment to investors rather than to all creditors are also excluded.[30]

Paragraph 1

4. The legislative provisions focus on rules for determining the governing law. That law governs: (a) jurisdictional, eligibility and procedural aspects of insolvency proceedings, such as commencement, conduct, administration and closure of insolvency proceedings; (b) effects of insolvency proceedings on the pre-commencement rights and claims (i.e. how each such right and claim would be

[20] GEI, paras. 1, 48, 49, 65 and 67, cross-referring to recommendations 15 and 16 of the Guide that set out standards for commencement of insolvency proceedings. When the debtor applies for commencement of insolvency proceedings, the standards are as follows: the debtor is or will be generally unable to pay its debts as they mature or its liabilities exceed the value of its assets (the Guide recommends that, in simplified insolvency proceedings, the eligible debtors should be allowed to apply for commencement of a simplified insolvency proceeding at an early stage of financial distress without the need to prove insolvency (rec. 294)). When creditor(s) apply for commencement of insolvency proceedings, the standards are as follows: the debtor is generally unable to pay its debts as they mature or the debtor's liabilities exceed the value of its assets.

[21] GEI, paras. 77–78.

[22] The Glossary, term (w).

[23] The Glossary, term (kk).

[24] See the text on the Purpose of legislative provisions preceding recommendation 160 of the Guide; and GEI, para. 75.

[25] The Guide, part five.

[26] As regards interim proceedings, see GEI, paras. 79–80. As regards restructuring proceedings, see the Digest of Case Law on the UNCITRAL Model Law on Cross-Border Insolvency, para. 11, under article 2.

[27] GEI, para. 69.

[28] GE, para. 22; and GEI, paras. 48 and 73.

[29] GEI, para. 78.

[30] GEI, para. 77.

treated in insolvency proceedings); and (c) post-commencement rights, claims, actions and disputes.

5. Examples of issues covered by (a) include: commencement standards; notices of commencement of insolvency proceedings; denial of application or dismissal of proceedings; types of proceedings; steps in proceedings; conversion of proceedings; supervision and approval requirements and mechanisms; and procedures for submission, verification and admission of claims.

6. Examples of issues covered by (b) include: the relative position of claims vis-à-vis each other (i.e. the ranking and priorities); avoidance; and restrictions and modifications to which the pre-commencement rights and claims may become subject in order to fulfil the collective aims of insolvency proceedings (e.g. a stay of proceedings[31] or subordination). They encompass the effects of insolvency proceedings on the validity and effectiveness of rights to commence arbitral proceedings under arbitration agreements concluded, valid and effective before the commencement of insolvency proceedings and on enforcement of valid and effective rights and claims arising from arbitral awards obtained before the commencement of insolvency proceedings.

7. Examples of issues covered by (c) include: rights and claims arising from the use and disposal of the insolvency estate assets and post-commencement finance; powers, duties, functions and liability of the insolvency representative and challenges against the insolvency representative's actions; determination and authorization of administrative expenses; challenges to a reorganization plan; and discharge of debt.

Paragraph 2

8. As stated in paragraph 2 of the legislative provision, the legislative provisions do not establish rules for determining the law applicable to the validity and effectiveness of rights and claims existing at the time of the commencement of insolvency proceedings. To determine that law, the court that controls or supervises the insolvency proceedings or another court adjudicating an insolvency-related matter (for example, under a jurisdictional clause in a contract with the debtor) will apply the PIL rules of its State, including any international conventions or other agreements in force for that State. This approach is reflected in recommendation 30 of the UNCITRAL Legislative Guide on Insolvency Law[32] (the "Guide"). For example, typically, the law governing the contract will determine if a contractual claim exists against the insolvent debtor and the amount of that claim; and the law of the State where the property is situated (lex rei sitae[33]) will determine if a security interest in immovable assets has been created in favour of a specific creditor. These legislative provisions do not displace those PIL rules and the applicable law resulting from the application of those rules.

9. Nevertheless, as noted in the commentary to paragraph 1 of the legislative provision above, insolvency proceedings produce effects on pre-commencement rights and claims and those effects fall under the governing law, not the PIL rules.[34]

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[31] "Stay of proceedings": 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 (the Glossary, term (rr)).

[32] Available at UNCITRAL Legislative Guide on Insolvency Law | United Nations Commission On International Trade Law.

[33] The Glossary, term (y).

[34] For examples of UNCITRAL and other international instruments that recognize effects of insolvency proceedings on pre-commencement rights and claims, see e.g. recommendations 3 and 88 of the Guide; recommendation 223 of the UNCITRAL Legislative Guide on Secured Transactions and the commentary to article 94 of the UNCITRAL Model Law on Secured Transactions; and article 14.2 of the UNIDROIT Convention on Substantive Rules for Intermediated Securities.

10. Consequently, the legislative provisions do not establish rules for localization of assets. Those rules are part of the PIL rules and hence relevant for assessing the validity and effectiveness of rights and claims existing at the time of the commencement of insolvency proceedings.[35]Other international instruments apply to them.[36]

11. Likewise, the legislative provisions do not establish jurisdictional rules.[37] Although relevant to the governing law, in particular recognition and enforcement of effects of insolvency proceedings across borders, jurisdictional rules are addressed in other texts, including UNCITRAL insolvency texts.[38] For example, the Guide recommends that the insolvency law should specify which debtors have sufficient connection to the State to be subject to its insolvency law and the grounds upon which a debtor can be subject to the insolvency law, to include that the debtor has either its centre of main interests (COMI) or an establishment in the State.[39]

12. Similarly, the legislative provisions do not establish rules for allocation of assets between or among possible concurrent proceedings. Other international instruments may address those aspects.[40]

Paragraph 3[41]

13. The legislative provisions were formulated to apply to any insolvency proceeding, but paragraph 3 contemplates the possibility that enacting States might wish to exclude some matters from their scope. Like article 1, paragraph 2 of both MLCBI and MLEGI, paragraph 3 refers to proceedings concerning banks, insurance companies and other similar entities as examples of proceedings that the enacting State might decide to exclude from the scope of application of the legislative provisions.

14. In enacting paragraph 3, a State may wish to make sure that it does not inadvertently and undesirably limit the application of the rules contained in the legislative provisions. The enacting State might wish to preserve the ability to apply the same rules in all insolvency proceedings regardless of sectors where insolvency proceedings take place and regardless of entities with respect to whom insolvency proceedings are opened. Where the enacting State wishes to indicate possible exceptions to the application of the legislative provisions, it is advisable that exclusions from the scope of the legislative provisions be expressly mentioned by the enacting State in paragraph 3, with a view to making the domestic insolvency law more transparent.

C. Definitions

5. The draft legislative provision and accompanying commentary reproduce the text that was before the Working Group at its sixty-first session, with minor amendments made in the draft commentary to reflect views expressed at that session.[42] The secretariat considered it premature to propose any additional terms for inclusion in the Definitions section of the draft text, in the light of outstanding issues related to those terms, for example:

[35] **A/CN.9/1126, paras. 40 and 62.**
[36] E.g. articles 90 and 91 of the UNCITRAL Model Law on Secured Transactions.
[37] **A/CN.9/1126, para. 62.**
[38] E.g. article 14 (g) of MLIJ and paras. 110–115 of the GE.
[39] See recommendation 10 and its accompanying commentary. A footnote to that recommendation notes that other grounds, such as presence of assets, are used in some jurisdictions, but are not recommended.
[40] **See e.g. Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (recast) (the "EIR recast"), article 15.**
[41] **A/CN.9/1126, para. 61.**
[42] **Ibid., paras. 63–65.**

(a) Lex arbitri,[43] as relevant to the consideration in the Working Group of the law governing effects of the commencement of insolvency proceedings on the treatment of ongoing or pending arbitral proceedings (see section H.3 below, also on related issues of litigation that have not yet been considered by the Working Group);

(b) Lex rei sitae, as relevant to the consideration in the Working Group of the law governing effects of the commencement of insolvency proceedings on rights in rem, deferred from previous sessions (see item (j) on the lex fori concursus list); and

(c) Lex societatis,[44] as relevant to the consideration in the Working Group of the law applicable to directors' obligations and liabilities in the period approaching insolvency. While it was agreed that the next draft of legislative provisions would bring within the scope of the lex fori concursus only those causes of action against directors that were closely related to insolvency proceedings, the Working Group deferred consideration of how that would be achieved (see the draft commentary to item (t) on the lex fori concursus list below).

1. Draft legislative provision

Definitions

For the purposes of these legislative provisions:

(a) "Lex fori concursus" means the law of the State in which the insolvency proceedings are commenced. [45]

2. Draft commentary

1. The "lex fori concursus", for the purpose of the legislative provisions, should be interpreted broadly as encompassing the insolvency law of the State of the opening of insolvency proceedings as well as its non-insolvency law relating to insolvency.[46] Sufficient connection to insolvency would be assessed on a case-by-case basis but usual examples of non-insolvency law with sufficient connection to insolvency include: (a) the law that addresses directors' obligations and liabilities in the period approaching insolvency in the context of insolvency proceedings;[47] (b) the law that addresses debt restructuring procedures in pre-insolvency proceedings;[48] (c) secured transactions law that, among other matters of relevance to insolvency, may address the treatment of pre-commencement finance in subsequent insolvency; (d) family law that may address the treatment of jointly owned assets in insolvency proceedings of individual entrepreneurs; (e) labour law that addresses workers' rights, the treatment and ranking of labour claims and handling of redundancies in case of insolvency; (f) tax and social security legislation that addresses the treatment and ranking of public debts; and (g) foreign investment law that may impose restrictions on foreign ownership of certain assets or operation of foreign investors in certain sectors of

[43] **Ibid., para. 42**. "Lex arbitri" governs largely procedural matters such as the steps that the tribunal must follow to ensure that its award is valid and enforceable (e.g. service of notice of arbitration to the parties) and the relationship between an arbitral tribunal and the courts in the jurisdiction where the tribunal sits. The lex arbitri is not a substantive law applied by the arbitral tribunal to resolve the dispute before it.

[44] There is no uniform definition of this term. The term may refer to the law of the State that governs company law relationships of the debtor or its internal affairs. See footnote 107 below.

[45] **At the sixty-first session of the Working Group, the prevailing view was to keep the legislative provision unchanged (A/CN.9/1126, para. 63).**

[46] **At the sixty-first session of the Working Group, the prevailing view was to replace the phrase "with sufficient connection to insolvency" with the phrase "relating to insolvency" (ibid.).**

[47] **At the sixty-first session of the Working Group, the prevailing view was to redraft item (a) to refer to directors' obligations and liabilities in the context of insolvency proceedings (ibid., para. 64 (a)).**

[48] **At the sixty-first session of the Working Group, the prevailing view was to redraft item (b) to refer to debt restructuring procedures in pre-insolvency proceedings (ibid, para. 64 (b)).**

economy (which would be relevant, for example, in case of debt-equity conversions or sale of the business (or part thereof) as a going concern).

2. Where the lex fori concursus defers to the law of another State, that reference is to be interpreted as reference only to substantive internal law of that State excluding its PIL rules, i.e. renvoi is excluded. This is in line with the approaches taken in other international texts.[49] The goal of that approach is to promote certainty as regards applicable law. In addition, the reference to the law of a foreign State would not encompass that State's public law, i.e. the law relating to the exercise of sovereign powers of a foreign State. Nevertheless, the lex fori concursus may address the treatment and ranking of foreign public claims (e.g. tax and social security claims).[50] The reference to the law of a foreign State does not encompass procedural law either since courts apply their own procedural law and do not apply any foreign rule that they consider procedural. As discussed in these legislative provisions in the relevant contexts, some matters (e.g. a set-off or limitation period) may be qualified as substantive or procedural, depending on the legal systems. The legislative provisions point to the law that will govern those matters in insolvency proceedings.

D. Primacy of international obligations

6. At its sixty-first session, the Working Group agreed that a provision on the primacy of international obligations would need to be included unless the final text would take the form of a supplement to the UNCITRAL insolvency model laws where such provision was already found.[51] In the light of that outstanding issue, the Secretariat considered it premature to draft a provision and an accompanying commentary on the matter. If the need for its inclusion arises, the provision and its accompanying commentary may build on article 3 of MLCBI, the UNCITRAL Model Law on Recognition and Enforcement of Insolvency-Related Judgments (MLIJ)[52] and MLEGI and its accompanying commentary. As suggested in the Working Group, the commentary to that provision may be expanded with references to treaties and other international agreements that address conflicts of law in insolvency proceedings, such as the Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment (Cape Town, 2001) (the "Aircraft Protocol")[53] and Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (recast) (the "EIR recast").[54]

E. Public policy exception

7. The draft legislative provision and accompanying commentary remain substantively the same as at the sixty-first session of the Working Group. At that session, the Working Group did not consider the expected outcome of the displacement of a foreign law: whether the lex fori concursus would apply in all instances, or the court would have the discretion to choose the law of a jurisdiction

[49] See e.g. references to the "internal law" in articles 5, 6 and 11 of the Hague Convention on the Law Applicable to Agency.

[50] See e.g. article 13(2) of MLCBI and its footnote b, as well as GEI, paras. 119–120.

[51] **A/CN.9/1126, para. 54.**

[52] United Nations publication, Sales No. E.19.V.8. Available at UNCITRAL Model Law on Recognition and Enforcement of Insolvency-Related Judgments (2018) | United Nations Commission On International Trade Law.

[53] Available at: www.unidroit.org/instruments/security-interests/.

[54] Binding and directly applicable in European Union (EU) member States. Its scope is limited to insolvency proceedings in respect of a debtor whose COMI is located in the EU (see recital 25). The EIR recast replaced and superseded Council Regulation (EC) No. 1346/2000 of 29 May 2000 on insolvency proceedings, which in turn was based on the Convention on Insolvency Proceedings (done at Brussels on 23 November 1995), which did not enter into force. Articles 7 to 18 of the EIR recast contain rules on the law applicable in insolvency proceedings.

that has a materially greater interest than the chosen jurisdiction or the lex fori concursus. The Working Group may wish to do so at its sixty-second session.

1. Draft legislative provision

Public policy exception

The application of the law determined in accordance with these legislative provisions may be refused only if the effects of its application would be manifestly[55] contrary to the public policy of this State.

2. Draft commentary

1. The legislative provisions include a public policy exception that aims at allowing courts in the enacting State to disapply a foreign law if applying that law would be manifestly contrary to the public policy of that State.

2. As the notion of public policy is grounded in national law and may differ from State to State, no uniform definition of that notion is attempted. However, since the legislative provisions deal with matters of international cooperation, public policy should be understood more restrictively than domestic public policy. This intention is conveyed by the expression "manifestly" in the legislative provision. The purpose is to emphasize that the public policy exception should be interpreted and applied narrowly and restrictively and invoked only under exceptional circumstances concerning matters of fundamental importance for the enacting State. The same narrow and restrictive interpretation of the exception should be followed regardless of the type of the proceeding (liquidation or reorganization).

3. The determination of public policy is to be performed in relation to the effects of the application of the foreign law designated by these legislative provisions in each concrete case. It is expected to be invoked where the relevant foreign rule, as applied to the facts of the case, would infringe the security or sovereignty of the State or produce a result which departs so radically from the enacting State's concepts of fundamental justice that its application would be intolerably offensive to the enacting State's basic values (e.g. the application of the law of the State that commenced insolvency proceedings for attaining political goals or the law of the State that effectively legitimizes illegal schemes (for example, evasion of mandatorily applicable law and obligations, such as environmental, human rights and other social responsibilities)).

F. Interpretation

8. At its sixty-first session, the Working Group agreed that a provision on interpretation would need to be included unless the final text would take the form of a supplement to the UNCITRAL insolvency model laws where such provision was already found.[56] In the light of that outstanding issue, the Secretariat considered it premature to draft a provision and an accompanying commentary on the matter. If the need for its inclusion arises, the provision and its accompanying commentary may build on article 8 of MLCBI and MLIJ and article 7 of MLEGI and their accompanying commentary. As suggested in paragraph 62 of document A/CN.9/WG.V/WP.183/Add.1, additional elements may be included in the future commentary to reflect the distinct scope of the project, in particular that the application of the legislative provisions may lead to the application of a foreign law and, consequently, determination and verification of that law and the engagement of

[55] **At the sixty-first session of the Working Group, in response to the suggestion to delete the word "manifestly" from the draft legislative provision, the prevailing view was to retain it (A/CN.9/1126, para. 66).**

[56] **Ibid., para. 55.**

foreign legal cultures, systems and concepts. In such situations, there could be an elevated tendency towards references to the local concepts and rules. Such tendencies should be avoided to achieve a uniform interpretation and application of the legislative provisions. When a question concerning a matter governed by the legislative provisions is not expressly settled therein, it would be expected to be settled in conformity with the general principles on which the legislative provisions are based. Where necessary, analogous legal rules could be applied to produce the effects intended under the legislative provisions.

G. Law applicable in insolvency proceedings by default: the lex fori concursus

9. In addition to the outstanding issues noted in the draft legislative provision on the lex fori concursus and its accompanying commentary below, the Working Group may wish to recall that:

(a) It deferred consideration of governing law issues arising in the context of concurrent proceedings (insolvency and non-insolvency), including issues of relevance to article 29 of MLCBI (e.g. deference to the lex fori concursus of the foreign main proceeding, including as regards the scope, duration, modification and termination of the stay of proceedings);[57]

(b) The prevailing view at the sixty-first session of the Working Group was to wait for the results of the work of UNIDROIT on digital assets and private law before completing the Working Group's consideration of the law governing the treatment of digital assets in insolvency proceedings.[58] The Working Group may wish to note that, at the time of preparation of this paper, UNIDROIT has not completed its work on that project, announcing public consultations on the draft;[59]

(c) The Working Group heard different views on whether there should be an exception to the lex fori concursus for contracts relating to immovable property;[60]

(d) The need to address specific issues arising from the insolvency of individuals were also noted.[61]

10. At the same time, the Working Group agreed that no exception to the lex fori concursus with respect to the treatment of intellectual property (IP) rights and licences in insolvency proceedings would be required.[62]

1. Draft legislative provision

Lex fori concursus as the default law governing all aspects of the commencement, conduct, administration and closure of insolvency proceedings and their effects

Except as provided otherwise in these legislative provisions, the lex fori concursus shall govern all aspects of the commencement, conduct, administration and closure of insolvency proceedings and their effects, including:

(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;

[57] **Ibid., paras. 68–72.**
[58] **Ibid., para. 39.**
[59] **Digital Assets and Private Law – Public Consultation – UNIDROIT.**
[60] **A/CN.9/1126, para. 49.**
[61] **Ibid., para. 72.**
[62] **Ibid., para. 38.**

(c) Constitution and scope of the insolvency estate;

(d) Protection and preservation of the insolvency estate[, including the scope, duration, modification and termination of a stay of proceedings];[63]

(e) Use and disposal of assets;

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

(g) Avoidance of certain transactions that could be prejudicial to certain parties;[64]

(h) Treatment of contracts, including automatic termination and acceleration clauses (ipso facto clauses);[65]

(i) Treatment of set-off;

(j) [Treatment of secured creditors;][66]

(k) Rights and obligations of the debtor;[67]

(l) Duties and functions of the insolvency representative;[68]

(m) Functions of the creditors and creditor committee;

(n) Treatment of claims;[69]

(o) Ranking of claims;[70]

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

(q) Distribution of proceeds;

(r) Closure of the proceedings;

(s) Discharge; and

[63] **At its sixty-first session, the Working Group deferred some issues related to this item, including whether a stay of proceedings should be listed separately (ibid., paras. 68–72).**

[64] **At its sixty-first session, the Working Group agreed to retain item (g) on the lex fori concursus but requested the secretariat to draft a variant thereto (ibid., para. 43). For the variant, see the relevant part of the revised commentary.**

[65] **At its sixty-first session, the Working Group agreed that the lex fori concursus should be the law governing the effects of commencement of insolvency proceedings on the validity and effectiveness of arbitration agreements (ibid., para. 41). This item on the lex fori concursus list addresses this issue, and this was reflected throughout the draft commentary.**

[66] **At its sixty-first session, the Working Group deferred further consideration of the treatment of secured creditors (ibid., para. 48).**

[67] **A/CN.9/1094, para. 80. At its sixtieth session, the Working Group deferred consideration of whether it is the lex fori concursus or the law of the recognizing State that would prevail in case of a conflict in addressing powers of the debtor to represent the insolvency estate in the recognizing State.**

[68] **Ibid. At its sixtieth session, the Working Group deferred consideration of whether it is the lex fori concursus or the law of the recognizing State that would prevail in case of a conflict in addressing powers of the insolvency representative to represent the insolvency estate in the recognizing State.**

[69] **At its sixty-first session, the Working Group agreed that the lex fori concursus should be the law governing the effects of commencement of insolvency proceedings on enforcement of arbitral awards (A/CN.9/1126, para. 41). This item on the lex fori concursus list addresses this issue, and this was reflected throughout the commentary.**

[70] **A/CN.9/1094, para. 82. At its sixtieth session, the Working Group, with reference to paragraph 84 of the commentary to recommendations 30–34 of the Guide, deferred consideration of whether and, if so, how to address rules for establishing equivalence between local and foreign claims for the purpose of their treatment in insolvency proceedings. The Working Group found the terms "ordinary claims" and "equivalence" in that commentary unclear and requiring further clarification.**

(t) Related actions (arising as a consequence of or are materially associated with an insolvency proceeding).[71]

2. Draft commentary

General

1. Under these legislative provisions, the lex fori concursus governs all aspects of insolvency proceedings and their effects unless explicitly stated otherwise. The observed convergence of substantive insolvency rules should make the application, as a rule, of the lex fori concursus to all aspects of the commencement, conduct, administration and closure of insolvency proceedings and their effects less problematic.[72]

2. The legislative provisions make the lex fori concursus applicable first to all aspects of the commencement, conduct, administration and closure of insolvency proceedings. Those aspects cover: (a) procedural matters (such as serving notices, convening meetings, establishing the quorum, ascertaining voting rules or specifying deadlines for submission of claims);[73] and (b) all post-commencement rights, obligations and claims, i.e. those arising from the insolvency proceedings, such as claims against the insolvency representative or in relation to post-commencement finance, realization of the insolvency estate or distribution of proceeds.

3. The legislative provisions make the lex fori concursus applicable also to the effects that insolvency proceedings produce, including on rights, claims and obligations that existed before the commencement of insolvency proceedings. For example, although under recommendation 4 of the Guide, a security interest effective and enforceable under law other than the insolvency law will be recognized in insolvency proceedings as effective and enforceable, enforcement of security rights may be stayed under the lex fori concursus unless and until the court grants relief from the stay (recs. 46–51 of the Guide). In addition, under recommendation 88 of the Guide, a security interest effective and enforceable under law other than the insolvency law may be subject to the avoidance provisions of the insolvency law on the same grounds as other transactions. Apart from a stay of proceedings and avoidance, the insolvency law may impose subordination of claims (such as those of related persons (rec. 184 of the Guide)). It may also prohibit enforcement of some contractual clauses (e.g. ipso facto clauses (rec. 70 of the Guide)) and give some discretion to insolvency representatives as regards treatment of contracts, including their assignment notwithstanding restrictions in the contract (rec. 83 of the Guide), and the use and disposal of assets, including their sale free and clear of encumbrances and other interests (recs. 52–62 of the Guide).

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

4. Under the legislative provisions, the lex fori concursus governs eligibility and jurisdiction and may provide for any special insolvency regimes and treatment that may apply depending on different sectors of the economy, the size of the debtor's business, the level of the debtor's indebtedness or other criteria. It also identifies the

[71] **At the sixty-first session of the Working Group, the prevailing view was to retain the item but with amendments that would align its formulation with the one used in a similar context in MLIJ: "related actions (arising as a consequence of or are materially associated with an insolvency proceeding)" (A/CN.9/1126, para. 52).**

[72] **A/CN.9/1088, para. 86. See, however, A/CN.9/1126, paras. 69–72: at the sixty-first session of the Working Group, a view was expressed that it would be inappropriate to impose the effects of the lex fori concursus, including as regards a stay of proceedings, extraterritorially. The Working Group deferred further consideration of those issues.**

[73] Some matters that are considered procedural in some jurisdictions (e.g. set-off or limitation period) may be considered substantive in other jurisdictions. The courts make this determination in accordance with the law of their States, e.g. the lex fori concursus in insolvency proceedings.

connecting factors for establishing jurisdiction over the debtor and the commencement and conduct of 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

5. Under the legislative provisions, the lex fori concursus determines commencement standards (whether it is the balance sheet test or cash flow test or both or something different or in addition). The lex fori concursus also specifies: (i) circumstances under which a particular type of insolvency proceeding may be commenced; (ii) whether it is the debtor only or creditors and other parties as well that will be able to apply for commencement of insolvency proceedings; and (iii) procedural steps and other requirements that would need to be fulfilled by the applicant for commencement (for example, in some jurisdictions, only a certain number of creditors or creditors holding a certain value of claims can commence insolvency proceedings). The lex fori concursus also defines criteria for denial of the application and dismissal of the proceedings and establishes rules for notices of application and commencement, including the content of those notices and the manner of giving them.

(c) Constitution and scope of the insolvency estate

6. Under the legislative provisions, the lex fori concursus determines which assets of the debtor are to be included in the insolvency estate and the time of constitution of the insolvency estate. It also governs the treatment of post-commencement assets (e.g. assets acquired after commencement of insolvency proceedings and assets recovered through avoidance or other actions).

7. Non-insolvency law of the State of the opening of insolvency proceedings, such as property law, human rights obligations, secured transactions law, family law, civil procedure law and tort law, may be applicable in the context of this item, including as regards characterization of an asset (tangible or intangible, movable or immovable) and rights thereto (property or contractual), determination of ownership and other property rights as well as the treatment of encumbered assets, third-party-owned assets, jointly owned assets and foreign assets.

8. This item is closely linked to [another item on the lex fori concursus list –] the treatment of secured creditors since encumbered assets may or may not be made part of the insolvency estate. In addition, this item is closely linked to the provisions on primacy of international obligations since the treatment of some assets in insolvency proceedings may be subject to a special regime binding on the State party thereto. Such regime may determine whether a particular asset is to be included in the insolvency estate and, if so, in which insolvency proceeding it should be administered in case of parallel proceedings.

(d) Protection and preservation of the insolvency estate[, including the scope, duration, modification and termination of a stay of proceedings]

9. Under the legislative provisions, the lex fori concursus governs all issues related to measures for protection and preservation of the insolvency estate, including provisional measures and measures upon commencement of insolvency proceedings (e.g. a stay of proceedings, a total or limited displacement of the debtor or the debtor-in-possession regime). Those issues include conditions for imposing those measures, their duration and scope as well as grounds and procedures for seeking and granting relief from the measures and other protections.

10. Difficulties may arise in enforcing effects of the lex fori concursus on the protection and preservation of the insolvency estate across borders, in particular as regards provisional measures and a stay of secured creditors' enforcement actions with respect to the collateral or execution of rights in rem. They could be mitigated to some extent by the domestic law enacting the UNCITRAL insolvency model laws

that provide for recognition of foreign proceedings and recognition and enforcement of insolvency-related judgments. However, the principle underlying MLCBI, for example, is that recognition of a foreign proceeding does not mean extending the effects of the foreign proceeding as they may be prescribed by the law of the foreign State (i.e. the lex fori concursus). Instead, recognition of a foreign proceeding entails attaching to the foreign proceeding consequences envisaged by the law of the recognizing State.[74] For example, the scope, duration, modification, suspension or termination of stay and other relief in the recognizing State are determined by provisions of the laws of that State, not the lex fori concursus.[75] They may thus be different in the State of the opening of the insolvency proceeding and in the recognizing State.

11. Nevertheless, under UNCITRAL insolvency texts, States are expected to cooperate and coordinate in cross-border insolvency cases to the maximum extent possible.[76] Means to achieve such maximum cooperation and coordination could be different, including by providing assistance to the foreign proceeding and the foreign representative under insolvency and non-insolvency laws. In addition, a basic principle of UNCITRAL insolvency texts is that the relief considered necessary for the orderly and fair conduct of a cross-border insolvency should be available to assist foreign proceedings whether on an interim basis or as a result of recognition.[77] The relief under articles 19–21 or additional assistance under article 7 of MLCBI may include deference to the lex fori concursus, including on the scope, duration, modification and termination of a stay of proceedings, if the domestic law of the recognizing State so provides (see articles 20 (2) and 21 (1) (g) of MLCBI). Such possible deference would be subject to the usual protections, including the public policy exception and adequate protection of interests of creditors and other interested persons, including the debtor (articles 6, 21 (2) and 22 of MLCBI).

12. In line with those objectives, the UNCITRAL insolvency model laws build safeguards against interference with the effects of the lex fori concursus. For example, article 14 (e) of MLIJ envisages that recognition and enforcement of an insolvency-related judgment may be refused if this would interfere with the administration of the debtor's insolvency proceedings, including by conflicting with a stay or other order that could be recognized or enforced in the MLIJ enacting State. Those proceedings could be the proceeding to which the judgment is related or other insolvency proceedings (i.e. concurrent proceedings) concerning the same insolvency debtor. While the concept of interference is somewhat broad, the provision gives examples of what might constitute such interference. Inconsistency with a stay, for example, would typically arise where the stay permitted the commencement or continuation of individual actions to the extent necessary to preserve a claim, but did not permit subsequent recognition and enforcement of any ensuing judgment. It could also arise where the stay did not permit the commencement or continuation of such individual actions and the proceeding giving rise to the judgment was commenced after the issue of the stay (and was thus potentially in violation of the stay).[78]

13. Other international texts, such as the Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment (Cape Town, 2001) (the "Aircraft Protocol"),[79] envisage deference to the lex fori concursus of the foreign main proceeding.

(e) Use and disposal of assets

14. Under the legislative provisions, the lex fori concursus determines: (i) effects of insolvency proceedings on the debtor's control of the business, including total or limited displacement of the debtor or debtor-in-possession; (ii) terms and limits for

[74] GEI, para. 194.
[75] GEI, para. 38.
[76] See e.g. chapter IV of MLCBI and chapter 2 of MLEGI.
[77] GEI, para. 35.
[78] GE, para. 107.
[79] Available at: www.unidroit.org/instruments/security-interests/ See in particular article XXX (4).

the use and disposal of the assets (e.g. creditor notifications, court approvals); (iii) the treatment of pre- and post-commencement finance, unauthorized transactions and transactions with related persons after commencement of insolvency proceedings, and causes of action against a counterparty in unauthorized transactions; and (iv) notions such as "ordinary course of business", "related persons", etc.

15. Non-insolvency law of the State of the opening of insolvency proceedings may apply to the use and disposal of assets, for example: family law may apply to the use and disposal of assets co-owned by the debtor (an individual entrepreneur) with family members; laws prohibiting or restricting foreign ownership in certain sectors of the economy will determine whether disposal of assets to foreigners is allowed and if so, under which conditions; secured transactions law may apply to the use and disposal of encumbered assets and their methods of sale; and environmental and other law may address conditions for relinquishment of assets (e.g. environmentally dangerous assets or assets hazardous to public health and safety) and who might be entitled to claim the relinquished assets.

16. Difficulties may arise in enforcing effects of the lex fori concursus on the use and disposal of the insolvency estate across borders, for example immovable property or payments by the debtor in the ordinary course of business, the latter not being understood uniformly across jurisdictions. As noted above in the context of the protection and preservation of the insolvency estate[, including the scope, duration, modification and termination of a stay of proceedings], States would be expected to cooperate and coordinate in cross-border insolvency cases to the maximum extent possible, including in the administration and supervision of the debtor's assets and affairs.

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

17. Under the legislative provisions, the lex fori concursus determines the nature and form of the plan; when it is to be proposed; who is permitted to prepare a plan; its content; its approval by creditors; treatment of dissenting creditors; whether court confirmation of the plan is required; the effect of the plan; and its implementation.

18. Non-insolvency law of the State of the opening of insolvency proceedings may apply, for example, to: (i) debt-to-equity conversions; (ii) redundancies, modifications in collective bargaining agreements and involvement of employees and trade unions in insolvency proceedings; (iii) foreign investment and foreign exchange controls; and (iv) protection of confidential or commercially sensitive information.[80]

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

19. Under the legislative provisions, the lex fori concursus determines: (i) types of transaction that can be avoided and types of transaction exempted from avoidance; (ii) avoidance criteria, including elements to be proven and defences;[81] (iii) the duration of the suspect period and from which date it runs retroactively; (iv) courts competent to hear avoidance actions in the State of the opening of insolvency proceedings; (v) who can commence avoidance and under which conditions; (vi) sources of covering expenses of avoidance actions, including permissibility of third-party funding and conditions and safeguards for raising such funding; (vii) effects of avoidance; (viii) liability of the counterparty to the avoidable transaction and remedies in case of non-compliance; and (ix) permissibility of avoidance in case of

[80] General contract law and thus rules outside the scope of these legislative provisions may apply to the implementation of the reorganization plan in those jurisdictions that provide for the closure of insolvency proceedings after approval (or confirmation where required) of the plan.

[81] Although not explicitly mentioned in the Guide, those defences may include that the transaction is subject to the law other than the lex fori concursus and that other law does not allow any means of challenging the transaction in the relevant case. Some States may choose to disallow that defence if the choice of that other law is abusive and detrimental to the interests of creditors and other parties in insolvency proceedings.

conversion of the proceedings and, if it is permitted, extent of avoidance and transactions that may be avoided as well as transactions that are exempted from avoidance in such cases.

20. Although these legislative provisions provide for an exception to the lex fori concursus with respect to labour contracts, they reaffirm that it is the lex fori concursus that governs avoidance of labour contracts or relationships. The legislative provisions envisage an exception to the lex fori concursus with respect to avoidance only for payments or transactions that took place in a payment or settlement system or in a regulated financial market. Avoidance in those cases is to be governed by the law applicable to that system or market.

[*The Working Group requested the secretariat to draft a variant on the basis of article 16 of the EIR recast.*[82] *A draft variant below is provided for consideration by the Working Group. The draft commentary will be revised to reflect the outcome of deliberations in the Working Group on the matter.*

> "Avoidance is governed by the lex fori concursus, except where the counterparty to the transaction that is subject of avoidance provides proof that the law of a State other than the lex fori concursus applies to that transaction and that other law does not allow avoiding the transaction in the relevant case.
>
> This provision may be disapplied if it is established that the law of that other State has no substantial relationship to the parties or the transaction, that there is no reasonable basis to apply that law to the transaction and that applying that law to the transaction in the relevant case will be detrimental to the general body of creditors and other parties in interest in the insolvency proceedings."]

(h) Treatment of contracts, including automatic termination and acceleration clauses (ipso facto clauses)

21. Under the legislative provisions, the lex fori concursus determines: (i) qualification of contracts; (ii) the treatment of contracts under which both the debtor and its counterparty have not yet fully performed their respective obligations (henceforth referred to as "continued contracts"), in particular the power of the insolvency representative to decide whether to continue performance of those contracts or reject or assign them, the time when those decisions should be made, and the time from which rejection will be effective retroactively; (iii) whether the insolvency law overrides automatic termination and acceleration clauses (also known as "ipso facto clauses") or they are left to be addressed under general contract law and, if the insolvency law overrides them, the power of the insolvency representative to reinstate contracts that were terminated just before the commencement of insolvency proceedings in order to avoid the application of those overriding provisions of the insolvency law; (iv) exceptions to the insolvency representative's powers in the preceding (ii) and (iii); (v) the treatment of post-commencement contracts; and (vi) the treatment of arbitration agreements.

22. Non-insolvency law of the State of the opening of insolvency proceedings may apply to, for example, qualification of contracts, calculation of damages and treatment of government contracts and arbitration agreements. For example, international commercial arbitration matters in the majority of States will be addressed by the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958)[83] (the "New York Convention") that, among others, requires courts of State parties to give full effect to arbitration agreements and deny the parties' access

[82] **A/CN.9/1126, para. 43.**

[83] United Nations, *Treaty Series,* vol. 330, No. 4739, p. 3. Also available at: Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958) (the "New York Convention") | United Nations Commission On International Trade Law.

to the court in contravention of their agreement to refer the matter to an arbitral tribunal (article II).

23. Under the legislative provisions, certain types of contract (e.g. in a payment and settlement system or in a financial market) and some aspects of labour contracts (e.g. their rejection or continuation) fall under an exception to the lex fori concursus.

[*The Working Group deferred consideration of contracts relating to immovable property (article 11 (1) of EIR (recast)). The draft commentary may need to be revised to reflect the outcome of deliberations of the Working Group on the matter.*]

(i) Treatment of set-off[84]

24. Under the legislative provisions, the lex fori concursus determines whether the set-off is permitted in insolvency proceedings and if so, with respect to which obligations and under which conditions it is permitted, in particular: (i) whether set-off is permitted only with respect to pre-commencement money obligations matured prior to the commencement of insolvency proceedings or also those that would mature after commencement of insolvency proceedings; (ii) whether obligations subject to set-off must arise under a single contract or may arise under multiple contracts (i.e. not necessarily be mutual or related); and (iii) whether the stay applies to the exercise of set-off rights and, if so, how creditors with set-off claims are treated (e.g. as secured creditors), or whether the stay does not apply and, if so, whether set-off is effectuated automatically upon commencement of insolvency proceedings. The lex fori concursus also governs the treatment of set-off of claims arising after the commencement of insolvency proceedings, and avoidance of pre-commencement set-offs and related transactions (e.g. purchasing claims at discounts with the intent of building up set-off rights).

25. There are different types of set-off (contractual, statutory, equitable, bank, etc.). Item (i) refers only to mandatorily applicable insolvency set-off that would apply irrespective of any contractual arrangements between contracting parties. The use of the word "treatment" in that item intends to convey that meaning and also that the lex fori concursus governs the treatment of set-off in insolvency proceedings irrespective of the law that governs the validity and effectiveness of set-off rights and claims existing at the commencement of insolvency proceedings.

26. The item is closely linked to other items on the list, including: item (d) on the protection and preservation of the insolvency estate[, including the scope, duration, modification and termination of a stay of proceedings]; item (g) on avoidance; item (h) on treatment of contracts; and item (n) on treatment of claims. It is also linked to an exception to the lex fori concursus for the law governing the effects of insolvency proceedings on the rights and obligations of the participants and avoidance actions in a payment or settlement system or in a regulated financial market. Under that exception, the effects of insolvency proceedings on set-off rights and obligations in those systems and markets are governed by the law applicable to those systems and markets.

(j) [Treatment of secured creditors]

[*The Working Group deferred the consideration of this item*.][85]

(k) Rights and obligations of the debtor

27. As noted above, under the legislative provisions, the lex fori concursus determines whether the debtor-in-possession regime or the total or limited displacement of the debtor will be in place. It also governs rights and obligations of the debtor, including its directors, in each of these regimes and in a specific insolvency case as well as conditions for conversion of one regime to another.

28. This item is linked to the other items on the lex fori concursus list, in particular item (e) that refers to the use and disposal of the assets of the insolvency estate, and in that context also to the definition of "ordinary course of business" and treatment of unauthorized transactions.

29. Non-insolvency laws may be applicable to this item, in particular, if the debtor is a natural person (in such case, human rights instruments may address the extent of limitations that may be imposed on the freedom of movement by the debtor, disclosure of the debtor's private correspondence and other personal data protection aspects). There may also be a close interaction of insolvency law with civil and criminal procedure law, for example as regards disclosure, examination, search and seizure warrants. In the cross-border insolvency context, the Hague Convention of 15 November 1965 on the Service Abroad of Judicial and Extrajudicial Documents in Civil or Commercial Matters[86] and the Hague Convention of 18 March 1970 on the Taking of Evidence Abroad in Civil or Commercial Matters[87] may apply.

[The *Working Group deferred consideration of whether it is the lex fori concursus or the law of the recognizing State that would prevail in case of a conflict in addressing powers of the debtor to represent the insolvency estate in the recognizing State.*]

(l) Duties and functions of the insolvency representative

30. Under the legislative provisions, the lex fori concursus governs the mechanisms for selection, appointment, removal and replacement of the insolvency representative, including the insolvency representative appointed on an interim basis; a method of calculating renumeration for insolvency representative services; the role of the court and creditors in oversight of the work done by the insolvency representative; and liability of the insolvency representative. With respect to the latter, non-insolvency laws may be applicable especially if the insolvency representative is subject to certain professional standards and regulations (e.g. accountants, lawyers, etc.). Apart from general duties, functions and powers of the insolvency representative, the lex fori concursus determines the authority conferred upon the insolvency representative in a specific case, which may include the authority to represent the proceeding across borders (article 5 of MLCBI) or to act in another State in respect of an insolvency-related judgment issued in the State of the opening of insolvency proceedings (article 5 of MLIJ), cooperate and directly communicate with foreign courts and representatives (article 26 of MLCBI) and give undertakings with respect to the treatment of foreign creditors' claims (see articles 28–32 of MLEGI).

31. In performing their functions across borders, insolvency representatives are subject to the domestic law of foreign States, including international treaties and other agreements to which those States may be parties. In those States that enacted the UNCITRAL insolvency model laws, the insolvency representative may benefit from expedited and direct access to the foreign courts without the need to meet formal requirements such as licences or consular action and without subjecting itself and the foreign proceeding to the jurisdiction of the foreign court for any purpose other than the application (see articles 9 and 10 of MLCBI).[88] The insolvency representative would have standing to request assistance under laws of the enacting State[89] and the commencement of an insolvency proceeding if the domestic conditions for commencing such a proceeding are met (article 11 of MLCBI).[90] Upon application for recognition of the foreign proceeding, the foreign representative can request provisional relief (article 19 of MLCBI). Upon recognition of the foreign proceeding, it may request an extension of that relief or granting additional relief and would have standing also to make petitions, requests or submissions concerning issues such as protection, realization or distribution of assets of the debtor or cooperation with the

[84] **A/CN.9/1126, para. 44.**

[85] **Ibid., paras. 45–48. For the history of consideration of this item at the previous sessions of the Working Group and issues raised on those occasions, see A/CN.9/WG.V/WP.183/Add.1, paras. 39–42.**

[86] For the status of the Convention and declarations and reservations made thereto, see www.hcch.net/en/instruments/conventions/status-table/?cid=17.

[87] For the status of the Convention and declarations and reservations made thereto, see www.hcch.net/en/instruments/conventions/status-table/?cid=82.

[88] GEI, paras. 108–111.

[89] See article 7 of MLCBI and article 6 of MLIJ; GEI, para. 105 and GE, para. 70.

[90] GEI, paras. 112–114.

foreign proceeding (see article 12 of MLCBI). It may also request relief to initiate actions under the law of the recognizing State to avoid or otherwise render ineffective legal acts detrimental to creditors (article 23 of MLCBI) and to intervene in proceedings instituted by or against the debtor (article 24 of MLCBI).

32. Those provisions are limited to providing standing and do not vest the insolvency representative with specific powers or rights or govern the fate of actions that the insolvency representative would decide to undertake.[91] These matters would depend on the foreign law and courts (see e.g. articles 5 of MLCBI and MLIJ). For example, if the insolvency representative applies for relief, it is the court in the recognizing State that would decide which relief to grant, and the insolvency representative will be subject to conditions that the court may order in connection with relief granted and the domestic law of the recognizing State (see e.g. articles 19, 21 and 22 of MLCBI). They may impose limitations on the powers that the insolvency representative has under the lex fori concursus. The usual limitations found relate to the use and disposal of immovable property of the debtor located abroad, removal of property from the foreign jurisdiction and the use of coercive measures (e.g. for obtaining evidence, gaining access to business books or records of the debtor). In some jurisdictions, the lex fori concursus may be seen as the source of the foreign representative's powers while the law of the recognizing State may be seen as the source of authority for implementing or enforcing those powers locally, even if some of those powers may be unfamiliar to the law of the recognizing State or that law may be silent about them, as long as those powers are not prohibited by the domestic law, and adequate protection of creditors and other interested persons is ensured. Those jurisdictions grant different types of relief to the foreign insolvency representative not limiting them to those available to a local insolvency representative under their laws. The domestic law may effectively defer to the lex fori concursus as regards duties and functions of the insolvency representative subject to the usual safeguards.

[*The Working Group deferred consideration of whether it is the lex fori concursus or the law of the recognizing State that would prevail in case of a conflict in addressing powers of the insolvency representative to represent the insolvency estate in the recognizing State.*]

(m) Functions of the creditors and creditor committee

33. The lex fori concursus governs mechanisms and the level of creditor participation in insolvency proceedings, in particular whether and, if so, when, creditor meetings are to be convened or a creditor committee is to be established and the role of those bodies in the oversight of insolvency proceedings; eligibility to participate in those bodies; the matters that would require creditor approval; a threshold for the approval; and mechanisms for seeking the approval and ascertaining that the approval was obtained.

34. The item is closely linked to the preceding two items that address rights and obligations of the debtor and duties and functions of the insolvency representative.[92] It is also linked to the next item (treatment of claims).[93]

(n) Treatment of claims

35. Under the legislative provisions, the lex fori concursus determines: (i) which creditors should be required to submit claims, types of claim that should be submitted, excluded claims and claims subject to special treatment (e.g. claims by related persons); (ii) the procedure for submission, verification and admission of claims,

[91] GEI, paras. 21 (d), 115–117, 197 and 200–208; GE, para. 69.

[92] For the description of the role of creditors and creditor committees, including in supervising the debtor-in-possession and the insolvency representative, see e.g. recommendations 126–136 of the Guide and accompanying commentary.

[93] Creditors may be able to assume certain functions in insolvency proceedings (e.g. participation in creditor meetings) after submitting claims, while the exercise of other creditor functions (e.g. approval of a reorganization plan) may be conditioned upon verification and admission of claims. See e.g. recommendations 169–184 of the Guide and accompanying commentary.

including the deadline for submission of claims, to whom they should be submitted and formalities for submission of foreign claims;[94] (iii) consequences of failure to submit a claim; (iv) rules for valuation of claims; (v) treatment of disputed claims; (vi) effect of submission and admission of claims; (vii) review of decisions related to claims (e.g. their rejection or special treatment); (viii) treatment of post-commencement claims; (ix) treatment of claims upon conversion; (x) accrual and payment of interest; and (xi) rules for giving undertakings as regards the treatment of foreign claims, including whether the insolvency representative is authorized to give such undertakings to foreign creditors in order to avoid opening parallel proceedings and if so, formal requirements, including the form and language of undertakings, with respect to which claims undertakings could be given and procedures for seeking approval, review and enforcement of those undertakings[95] (under MLEGI, where such an undertaking was given and approved, the affected claims would be treated in accordance with the treatment they would receive in an unopened parallel proceeding). Notwithstanding the exception to the lex fori concursus for some aspects of labour contracts and relationships in these legislative provisions, the lex fori concursus determines the status and treatment of labour claims, subject to such possible undertakings.

36. Different non-insolvency laws may be applicable, such as secured transactions law in relation to the treatment of secured creditors' claims. In addition, criminal law may interact with the insolvency law in relation to the treatment of false claims. International conventions, such as the Hague Convention Abolishing the Requirement of Legalisation for Foreign Public Documents (5 October 1961), may be applicable to submission, verification and admission of foreign claims. Special rules may apply to the treatment of (foreign) public claims and claims emanating from arbitral awards. In most States, the New York Convention will be applicable to the treatment of foreign and non-domestic[96] arbitral awards.

37. This item is linked to the items on the treatment of secured creditors and set-off as well as on the implementation of a reorganization plan.[97]

(o) Ranking of claims

38. Under the legislative provisions, the lex fori concursus determines the order in which claims will be satisfied from the estate, including claims of the insolvency representative, claims arising after commencement of insolvency proceedings and administrative costs and expenses. It specifies the classes of creditors that will be affected by the insolvency proceedings and the treatment of those classes in terms of priority and distribution. Where subordination is envisaged, the lex fori concursus governs the conditions and limits of subordination. Where giving undertakings as regards the ranking of foreign claims is allowed in order to avoid opening parallel proceedings,[98] the lex fori concursus determines formal requirements, including the form and language of undertakings, with respect to which claims undertakings could be given and procedures for seeking approval, review and enforcement of those undertakings. Under MLEGI, where such an undertaking was given and approved, the affected claims would be treated in accordance with the treatment they would receive in an unopened parallel proceeding, including as regards their ranking. Notwithstanding the exception to the lex fori concursus for labour contracts and relationships in these legislative provisions, the lex fori concursus determines the ranking of labour claims, subject to such possible undertakings.

[94] See articles 13 and 14 of MLCBI and accompanying commentary in paras. 118–126 of GEI.
[95] See e.g. articles 28–32 of MLEGI and article 36 of the EIR recast.
[96] The term "non-domestic" embraces awards which, although made in the State of enforcement, are treated as "foreign" under its law because of some foreign elements in the proceedings, e.g. another State's procedural laws are applied. See the New York Convention Guide, available at https://uncitral.un.org/en/texts/arbitration.
[97] The plan usually addresses the treatment of creditor claims and may also stipulate the applicable law.
[98] See e.g. articles 28–32 of MLEGI and article 36 of the EIR recast.

39. Different non-insolvency laws may apply to the priority of claims in insolvency proceedings generally and in any given insolvency proceeding specifically, including the labour law that may encompass international labour conventions for State parties to those conventions;[99] tax law; secured transactions law; and tort law. Special rules may apply to the ranking of (foreign) public claims.

40. Difficulties may arise in achieving recognition of the effects of the lex fori concursus on the ranking of claims across borders, especially for public claims.[100]

[*With reference to paragraph 84 of the commentary to recommendations 30–34 of the Guide, the Working Group deferred consideration of whether and, if so, how to address rules for establishing equivalence between local and foreign claims for the purpose of their treatment in insolvency proceedings. The Working Group found the terms "ordinary claims" and "equivalence" in that commentary unclear and requiring further clarification.*]

(p) Costs and expenses relating to the insolvency proceedings

41. Under the legislative provisions, the lex fori concursus determines criteria relating to the allowance of administrative expenses, assessment of expenses, the role of the court in approval of expenses and distribution of costs and expenses relating to insolvency proceedings, in particular which expenses would be covered from the insolvency estate, which may need to be covered by creditors or other parties in interest and for which the insolvency representative may be personally liable. The lex fori concursus also determines the treatment of debtors whose assets and sources of revenue are insufficient to meet the costs of administering the insolvency proceeding, in particular whether in such cases the application will be denied or alternative mechanisms for covering costs of administering insolvency proceedings will be used and if so, which ones. It also determines rules related to third-party funding.

42. This item is linked to the other items on the lex fori concursus list, in particular items (g) on avoidance, (h) on treatment of contracts and (n) on treatment of claims. For example, costs and expenses relating to the insolvency proceedings would include costs and expenses of participation of the insolvency representative in various proceedings impacting the insolvency estate, such as litigation or arbitral proceedings as regards disputed claims or avoidance proceedings.

(q) Distribution of proceeds

43. Under the legislative provisions, the lex fori concursus establishes rules for distribution of proceeds, which may be different for liquidation and reorganization, and for steps to be taken if it is determined that no distribution can be made.[101]

44. This item is closely linked to the other items on the lex fori concursus list, in particular item (n) on treatment of claims and item (o) on ranking of claims. If giving undertakings as regards the treatment of foreign claims in order to avoid opening parallel proceedings is allowed under the lex fori concursus,[102] the affected claims would be treated in accordance with the treatment they would receive in an unopened parallel proceeding, including as regards the distribution of proceeds.

(r) Closure of the proceedings

45. Under the legislative provisions, the lex fori concursus determines the manner in which a proceeding is to be concluded and closed, the prerequisites for closure, the procedures to be followed and whether conversion constitutes formal closing of the

[99] E.g. the ILO Protection of Workers' Claims (Employer's Insolvency) Convention, 1992 (No. 173).

[100] See article 13 (2) of MLCBI and accompanying commentary.

[101] General contract law, and thus rules outside the scope of these legislative provisions, would apply to the distribution of proceeds in reorganization proceedings if the proceedings close after approval (or confirmation where required) of the reorganization plan and the distribution of proceeds takes place in accordance with the distribution rules contained in the reorganization plan.

[102] See e.g. articles 28–32 of MLEGI and article 36 of the EIR recast.

proceeding being converted. The lex fori concursus specifies the party that can apply to close the proceedings; whether the application and the decision to close should be publicized; and whether creditors could be heard on the application.

(s) Discharge

46. Under the legislative provisions, the lex fori concursus determines: (i) general conditions for discharge, including debts that are not dischargeable; (ii) procedures and preconditions for discharge, which may be different in different types of proceedings (liquidation, reorganization, standard or simplified proceedings); (iii) the date from which discharge will be effective;[103] and (iv) criteria for denying discharge and revoking discharge granted.

47. [Difficulties may arise with the cross-border recognition and enforcement of effects of the lex fori concursus on discharge of debts governed by another law.][104]

(t) Related actions (arising as a consequence of or are materially associated with an insolvency proceeding)[105]

48. Item (t) is a catch-all provision intended to cover actions not specifically named on the lex fori concursus list that nevertheless arise as a consequence of an insolvency proceeding or are materially associated with an insolvency proceeding. Examples include: (i) insolvency-related adjustments that lead to the special treatment of claims of related persons or claims against such persons; and (ii) actions based on insolvency law to hold directors liable for their actions causing or contributing to insolvency.[106]

49. With respect to actions against directors, in comparison with effects of insolvency proceedings on directors' obligations and liabilities arising during insolvency proceedings encompassed by item (k), which are always governed by the lex fori concursus, the legislative provisions do not envisage that effects of insolvency proceedings on all directors' obligations and liabilities in the period approaching insolvency should be governed by the lex fori concursus. In most cases, the law applicable to company law relationships of the debtor (lex societatis[107]) will continue to apply to them notwithstanding the opening of insolvency proceedings. Item (t) intends to capture very limited grounds that may give rise to the liability of directors and causes of action against directors upon commencement of insolvency proceedings under insolvency law. Such grounds include in many jurisdictions wrongful trading and violation of the duty to file for commencement of insolvency proceedings. Other than in those very few cases closely connected to insolvency law and insolvency proceedings, it will be inappropriate to subject directors' obligations and liability in the period approaching insolvency to the retrospective effect of the lex fori concursus.

50. For example, in some jurisdictions directors may face criminal liability for not filing for commencement of insolvency proceedings within the period specified in the law after occurrence of certain events. In other jurisdictions, no such requirement may apply and instead directors may be encouraged to engage in out-of-court debt restructuring negotiations. The limited interpretation of item (t) in its application to directors ensures that directors in the second group are shielded from unexpected liability and obligations that would apply to and be expected by directors in the first group. Risks of exposure to such unexpected liability and obligations may be different depending on whether insolvency proceedings are opened at the location of: (i) COMI

[103] Reference to "their effects" in the chapeau of the legislative provision is intended to capture both situations, when discharge is granted during insolvency proceedings and after their closure (**A/CN.9/1126, para. 74**).

[104] **Ibid.**

[105] **Ibid., para. 52.**

[106] **Ibid., paras. 50 and 73.**

[107] There is no uniform understanding of the lex societatis. Some jurisdictions follow the "incorporation" approach, while other jurisdictions follow the "real seat" approach with the understanding of the latter not being uniform either. Under the "incorporation" approach, the law of the jurisdiction in which the company is formed or incorporated applies to all aspects of governance of that company; under the "real seat" approach, the law of the country where the company has its "real" seat (i.e. its management and control centre) governs those matters.

that is the same as the debtor's place of registration or incorporation or "real seat"; (ii) COMI that is different from the debtor's place of registration or incorporation or "real seat"; (iii) the debtor's establishment; or (iv) the debtor's assets. The risks are higher where insolvency proceedings are commenced by creditors in a non-COMI jurisdiction. In other cases, the assessment conducted as regards the lex societatis may be similar to the assessment of the COMI with the result that the lex societatis will most likely be the same as the lex fori concursus.

51. In addition, if the lex fori concursus follows the broad interpretation of "directors", as for example recommended in part four of the Guide,[108] different public policy considerations, remedies and enforcement mechanisms, including disqualification, may apply depending on persons found to be in factual control of the debtor's business in the period approaching insolvency. Some directors (e.g. institutional lenders) may not be made subject to the foreign lex fori concursus.

H. Exceptions to the lex fori concursus

1. Labour contracts and relationships

11. The Working Group agreed to revise the draft legislative provision as set out below. The draft commentary was revised to reflect those changes.[109]

(a) Draft legislative provision

Law governing the effects of insolvency proceedings on labour contracts and relationships

The effects of insolvency proceedings on labour contracts and relationships shall be governed by the law applicable to the contract or relationship.[110]

(b) Draft commentary

1. According to this legislative provision, the effects of insolvency proceedings on labour contracts and relationships are to be governed by the law applicable to those contracts and relationships. Reference to that law intends to encompass the labour law, the insolvency law and any other law that may be relevant to labour contracts or relationships.

2. The treatment of labour claims and ranking of labour claims are not covered by the exception found in this provision. The lex fori concursus (if different from the law applicable to the labour contract or labour relationship, henceforth referred to as the "foreign lex fori concursus") remains applicable to them. The same applies to qualification of a contract or relationship as a labour contract or relationship and to avoidance of labour contracts or any parts thereof (e.g. unreasonable remuneration packages as a consequence of the modification of labour contracts or relationships between the debtor and chief executive officers or other managers in the period approaching insolvency). However, where the lex fori concursus authorizes giving undertakings with respect to foreign labour claims in order to avoid opening parallel proceedings (see the commentary to items (n), (o) and (q) on the lex fori concursus list above), the affected labour claims could be treated in accordance with the treatment they would receive in an unopened parallel proceeding.

3. The rationale for the exception to the application of the lex fori concursus found in the legislative provision is that labour contracts and relationships raise many

[108] Encompassing any person exercising factual control over the debtor (e.g. de facto directors, shadow directors, shareholders, lenders, etc.) (rec. 258 and its accompanying commentary).

[109] **A/CN.9/1126, paras. 75–79.**

[110] **At its sixty-first session, the Working Group agreed to this formulation (ibid., para. 79).**

socioeconomic policy considerations. For that reason, States usually devise a special regime for the treatment of issues arising from labour contracts and labour relationships in insolvency. In some insolvency laws, priority is given to maintaining continuity of employment over other objectives of insolvency proceedings, such as maximization of value of the estate for the benefit of all creditors. This may be evidenced by a focus on sale of the business as a going concern with the transfer of existing employment obligations, as opposed to liquidation or reorganization where those obligations may be altered or terminated. Mandatory provisions of law, including those found in international treaties,[111] may: protect workers against unfair dismissal and discrimination; provide for a financial safety net for workers; impose restrictions on the rejection or modification of labour contracts[112] and conditions for implementing redundancies (including an advance notice to relevant State authorities); and ensure workers' rights to be properly informed about all matters arising from insolvency proceedings affecting their employment status and entitlements. Different regimes may apply in liquidation and reorganization. For example, in some States, employees follow the business in case of sale as a going concern in both liquidation and reorganization, in others only in reorganization.

4. The legislative provision aims to reduce the risk of uncertainties or inconsistencies with respect to the treatment of labour contracts and relationships in insolvency proceedings. That risk increases if the effects of insolvency proceedings on those matters are governed by the foreign lex fori concursus. Providing more certainty and consistency to workers' expectations is justified because workers usually have a relatively weaker bargaining position than their employer, especially where no collective bargaining agreements are in place. In addition, workers may be unfamiliar with insolvency proceedings and protections accorded to them in case of financial difficulties of their employer and may remain uninformed and unaware of plans related to their employment status. Insolvency proceedings may be used to erode their protections, for example, where the business is to be sold as a going concern and the elimination of onerous employment contracts could increase the sale price, or where the debtor uses an application for insolvency as a means of obtaining relief from onerous obligations arising from labour contracts or relationships.

5. Nevertheless, the approach taken in the legislative provision may remove the flexibility that may be desirable and necessary for continuing the operation of the business, preserving employment and guaranteeing salaries, in particular in reorganization. That approach may also intervene in the efficient conduct and administration of insolvency proceedings where the debtor has workers to whom different arrangements for the treatment of labour contracts or relationships apply. A need would arise to assess all those different arrangements, for example, if the debtor has workers in different jurisdictions where the local labour law is mandatorily applicable to labour contracts or relationships. Such a need may also arise where freedom to choose the law applicable to labour contracts or relationships exists. That freedom is usually accompanied by safeguards to protect workers from the adverse consequences of their own, but potentially coerced or uninformed, agreement with the chosen law. Those safeguards may vary across jurisdictions (for example, with respect to non-competition clauses). They usually include that a choice of law may not have the result of depriving workers of the protection afforded to them by provisions that cannot be derogated from by agreement under the law that, in the absence of choice, would have been applicable (which for many States would include provisions of international labour treaties binding on them as well as constitutional guarantees) or that would have more connection with the labour contract or relationship.

6. However, without that exception, the effects of insolvency proceedings on the treatment of labour contracts and relationships may end up being governed by the law of insolvency proceedings that may perform only a coordinating role with no or very

[111] See e.g. the ILO Termination of Employment Convention, 1982 (No. 158).

[112] See recommendation 71 of the Guide and accompanying commentary.

distant connection to a given labour contract or relationship. This would necessitate reconciling protection afforded to workers under the foreign lex fori concursus, the chosen law, where applicable, and the law that would have been mandatorily applicable in any event. Envisaging a combination or hierarchy of applicable laws may be another solution but, while preserving flexibility, it may also impede the efficient conduct and administration of insolvency proceedings since courts would be expected to compare implications of the application of various labour regimes.

7. The public policy exception would allow the court to displace the application of a foreign law that would be manifestly contrary to the public policy of its State (e.g. that effectively legitimizes modern slavery, etc.).

2. Payment or settlement systems and regulated financial markets

12. At its sixty-first session, the Working Group agreed to add the word "regulated" before "financial markets", and to delete the word "solely", in the draft legislative provision found in paragraph 58 of document A/CN.9/WG.V/WP.183/Add.1. [113] The draft legislative provision reflects that agreement.

13. At the same session, the Working Group requested the secretariat to reflect in an accompanying commentary: (a) the content of paragraph 50 of document A/CN.9/WG.V/WP.179 that explained the intended scope of the exception; (b) possible exceptions to that exception; and (c) aspects related to digital assets. [114] The draft commentary was prepared accordingly and will be expanded in due course. The Working Group may wish to consider whether the legislative provision itself should delineate the scope of the exception more narrowly in the light of a wide range of autonomous and automated systems in the digital world that are used to effectuate online payments and settlements to which the exception may not be intended to apply.

(a) Draft legislative provision

Law governing the effects of insolvency proceedings on the rights and obligations of the participants and avoidance actions in a payment or settlement system or in a regulated financial market

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 shall be governed by the law applicable to that system or market. That law shall also govern avoidance actions that may be taken with respect to payments or transactions that took place in that system or market.

(b) Draft commentary

1. According to this legislative provision, the effects of insolvency proceedings on the rights and obligations of the participants and avoidance actions in a payment or settlement system or in a regulated financial market are to be governed by the law applicable to that system or market.

2. The systems and markets intended to be covered by the exception are tightly integrated multilateral systems and markets where the insolvency of one participant could result in a series of defaults in back-to-back transactions, potentially causing financial distress to other system or market participants and in the worst case, the financial collapse of other counterparties, including regulated financial institutions. [115] This domino effect is often referred to as systemic risk. [116]

[113] **A/CN.9/1126, para. 53.**
[114] **Ibid.**
[115] **A/CN.9/1094, para. 87.**
[116] **A/CN.9/WG.V/WP.179, para. 50 cross-referring to the commentary to recs. 101–107 of the Guide (see in particular, para. 213 of that commentary).**

3. Inclusion of the word “regulated” in the legislative provision indicates that the exception applies, in addition to payment and settlement systems, only to regulated financial markets, i.e. those that would be subject to supervision or control by the regulatory authorities in the State under whose law the market operates. The primary function of such regulatory authorities is to protect public interests. The fact that those markets are regulated makes their identification and the identification of the participants in those markets easier in case of insolvency because the regulated markets are usually under an obligation to register themselves and identify their participants. Those registration and identification requirements may facilitate delineating narrowly cases to which the exception should apply as far as the markets are concerned.

4. “Payment and settlement systems” are mentioned separately from regulated financial markets since, although they are part of the financial markets and represent a major component of their infrastructure, “payment and settlement systems” may also operate autonomously, outside any financial market. Unlike financial markets, payment and settlement systems are not qualified by the word “regulated” in the legislative provision. This is because, unlike financial markets, they are seldom regulated. Nevertheless, they are included in the exception because, although unregulated, many are considered systematically important. A failure in one system may produce unpredictable results, including a failure in the chain of such a magnitude that it would necessitate intervention of regulatory authorities in otherwise unregulated systems, for the protection of public interests.

5. The systems and markets covered by the exception cannot tolerate risks of forum shopping and unpredictability in the governing law which may result if the law other than the law applicable to the market or system is made applicable to them. Such risks will be present if the effects of insolvency proceedings on systems and markets would be governed by the lex fori concursus: insolvency proceedings with respect to a single participant in the system or market may be opened in various jurisdictions while there are usually numerous participants in any single system or market. Only the application of one law to all operations in payment and settlement systems and regulated financial markets may guarantee the legal certainty required to ensure the smooth and correct operation of the systems and markets covered by the exception.

6. The sectors to which this exception applies operate under standard rules, guidelines and agreements that reinforce the application of the law of the system or the market to all aspects related to that system or market, including effects of insolvency proceedings. Any deviation from those standards may produce negative consequences not only for non-compliant systems or markets but also on the general investment climate in jurisdictions where they operate.

7. The exception contained in the legislative provision applies to digital systems and markets to the extent they meet the criteria set out above. The exception does not apply to [*to be elaborated reflecting the outcomes of the Working Group’s further deliberations of those matters (see para. 13 above preceding the draft provisions)*.]

3. Ongoing or pending arbitral proceedings

14. At its sixty-first session, the prevailing view was to provide for the lex arbitri as the law governing the effects of insolvency proceedings on ongoing or pending arbitral proceedings. Accordingly, the draft legislative provision may read as follows:

Law governing the effects of insolvency proceedings on ongoing or pending arbitral proceedings

The effects of insolvency proceedings on ongoing or pending arbitral proceedings shall be governed by the lex arbitri.

15. Having noted that the Working Group, at that session, considered only arbitration aspects of article 18 of the EIR recast from which the above rule originated, some delegations expected that the Working Group, at its next session, would take up also litigation aspects of article 18.[117] In the light of the expected consideration of those interconnected issues in the Working Group holistically, the Secretariat considered it premature to draft a commentary to the draft legislative provision.

[117] **A/CN.9/1126, para. 81.**