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Draft legislative guide on insolvency law

Note by the Secretariat

Contents

[The Introduction and Part One of the draft Guide appear in document A/CN.9/WG.V/WP.63; Part Two, Chapter I appears in documents A/CN.9/WG.V/WP.63/Add.1 and Add.2; Chapter II.A and B appear in documents A/CN.9/WG.V/WP.63/Add.3 and Add.4; Chapter III.A-F appear in documents A/CN.9/WG.V/WP.63/Adds.5-9; Chapter IV.A-B appears in document A/CN.9/WG.V/WP.63/Add 10; Chapters V-VII appear in subsequent addenda]

* This document was submitted late because of the need to complete consultations and finalize consequent amendments.

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Paragraph numbers in [...] refer to relevant paragraph numbers in A/CN.9/WG.V/WP.58, the previous version of the text of the Guide.

Recommendation numbers in [...] refer to relevant recommendations in A/CN.9/WG.V/WP.61 and A/CN.9/WG.V/WP.61/Add.1, the previous version of the recommendations. Additions to the recommendations are indicated in this document by underlined text.

Part Two (continued)

IV. Participants and institutions

C. Creditors

1. Classes of creditors

260. [213] There are many diverse and competing interests in an insolvency proceeding. For the most part, creditors are creditors by virtue of having entered into a legal and contractual relationship with the debtor prior to the insolvency. There are creditors, however, who have not entered into such an arrangement with the debtor, such as taxing authorities (who will often be involved in insolvency proceedings) and tort claimants (whose participation will generally be less common). Accordingly, [214] the rights of creditors will be governed by a number of different laws.

261. [214] While many creditors may be similarly situated with respect to the kinds of claims they hold based on similar legal or contractual rights, others may have superior claims or hold superior rights. Even within the same class of creditor, there will be competing rights such as secured creditors that have better security than others. For these reasons, insolvency laws generally rank creditors by reference to their claims, an approach not inconsistent with the objective of equitable treatment. In developing these categories, it is desirable that a balance be reached between the legal and commercial rights of creditors based upon fairness and the commercial reasonableness of their relative positions, at the same time observing the objective of equality of treatment, preserving legitimate commercial expectations and fostering predictability in commercial relationships. There is, however, a limit on the extent to which these goals can be achieved, given the balance that is desirable in an insolvency law between these competing objectives and other public policy considerations. To the extent that these broader public interests compete with private interests, they may lead to a distortion of normal commercial incentives. Where these public interests are given priority, and equality of treatment based upon the classification of claims is not observed, it is desirable that the policy reasons for establishing that priority be clearly stated in the insolvency law. In the absence of equality of treatment, this approach will at least provide an element of transparency and predictability in the area of claims (see Part two, chapter VI.A) and distribution (see Part two, chapter VI.C).

262. [216] Creditors of an insolvent debtor generally fall into categories of secured creditors, preferred or priority creditors, and unsecured or ordinary creditors. In some insolvency laws, employees are treated as a separate interest group.

[NOTE TO THE WORKING GROUP: The Working Group may wish to consider whether the Guide should provide information on the different types of creditors and their interests. Would it be useful, for example, if this part of the Guide were to include a summary of the ways in which secured creditors may be affected by insolvency proceedings? A discussion of the ranking of claims appears in chapter VI.C]

2. Participation of creditors in insolvency proceedings

(a) Introduction

263. [192] Creditors have a significant interest in the debtor's business once an insolvency proceeding is commenced. As a general proposition, these creditor interests are safeguarded by the appointment of an insolvency representative. In addition, many insolvency laws provide for creditors to be directly involved in the proceedings in different ways and for a number of reasons. As the party with the primary economic stake in the outcome of the proceedings they may lose confidence in a process where key decisions are made without consulting them by individuals who may be perceived by creditors as having limited experience or expertise in the debtor's type of business or a lack of independence, depending upon the manner in which the representative is appointed. Creditors are often in a good position to provide advice and assistance with respect to the debtor's business and to monitor the actions of the insolvency representative, providing a check against possible abuse of the insolvency process and excessive administrative costs.

(b) Extent of involvement of creditors in the decision-making process

264. [194] There are varying possible degrees of involvement of creditors in decision-making in insolvency proceedings and insolvency laws adopt a wide range of approaches and mechanisms for creditor participation. An approach which allows only a low level of participation is reflected in those insolvency laws which provide that the insolvency representative makes all key decisions on uncontested general matters of administration, with the creditors playing a marginal role and having little influence. Lack of creditor participation in this model may be balanced against the key obligations of the insolvency representative one of which is to protect the value and security of the insolvency estate, ultimately for the benefit of creditors generally. Such an approach may be effective where an experienced insolvency representative is appointed to the proceedings because it avoids potential delays and the costs involved in managing the participation of creditors, and where the insolvency system provides a high level of regulation of the process and its participants.

265. [195] Other approaches afford creditors greater participation in the proceedings. This participation may range from participation at an initial meeting where certain matters are considered, to an ongoing role which may require creditors to perform only an advisory function or to approve certain acts and decisions of the insolvency representative. These may include the sale of significant assets, verification of claims and approval of the insolvency representative's final report and accounting, or may even hold primary responsibility for some administrative functions. Creditors may also be able to seek the dismissal and replacement of the insolvency representative by the court for failure to perform its functions and duties or for negligence. Creditors may also have a role in requesting

or recommending action from the court, for example, a recommendation that the reorganization be converted to liquidation or that an avoidance action be commenced by the insolvency estate or by creditors on behalf of the estate. In terms of costs, the creditors may also be given a role in monitoring the administrative expenditure and remuneration of the insolvency representative.

266. [196] Some insolvency laws draw a distinction between liquidation and reorganization in setting the level of creditor participation. In liquidation, although generally it may not be important for creditors to intervene in the process or participate in decision-making, they can provide a valuable source of expert advice and information on the debtor's business, particularly where it is to be sold as a going concern. It may be desirable for creditors to receive reports on the conduct of the liquidation to ensure their confidence in the process, as well as its transparency. In reorganization, however, the input of creditors is both useful and necessary, as they will generally determine whether the reorganization plan will be supported and successful or not.

267. In terms of the mechanisms for participation, some insolvency laws allow creditors to participate as a general body of creditors. Other laws provide for the formation of a committee (on which creditors sometimes may share representation with shareholders and possibly other interested parties) to facilitate the participation in the administration of the estate. The committee will generally be a smaller number of creditors (in some laws, a specified number). A further approach is to provide for the appointment of a single person to represent certain groups of creditors (such as groups holding at least ten per cent of the debt). In one law where this approach has been adopted the rationale is to facilitate more orderly and timely participation and avoid the delays and disputes previously encountered.

268. [198] An important issue that may need to be considered where an insolvency law allows creditors to participate actively in the process is how to overcome creditor apathy and encourage participation in the proceedings. It is not uncommon for creditors to adopt the view, even where the insolvency law provides for active participation, that nothing will be gained from such participation, especially where the return to creditors is unlikely to be significant and where participation may in fact require further expenditure of time and money. This common concern can be addressed to some extent by the overall balance that an insolvency law strikes between the different interests of the parties involved in the proceedings (see for example, Part two, chapter IV.A.2) and by specific measures relating, for example, to selection of the creditors committee and the functions to be performed by that committee (or by creditors generally where there is no committee) (see below).

(c) General body of creditors [assembly of creditors]

269. Where the general body of creditors is required or permitted to participate in the insolvency proceedings, an insolvency law should clearly establish the powers and functions of that body and establish the manner in which meetings of creditors in general may be convened. It is also desirable that an insolvency law determine the extent to which secured creditors can or should participate at meetings of the general body of creditors; for example, some insolvency laws require secured creditors to surrender their security before they can participate in the proceedings and vote as a member of the creditor body.

(i) Functions

270. As noted above, the functions to be performed by creditors vary widely between insolvency laws. In some cases, they perform a general advisory function and the insolvency representative may refer matters to the creditors, but will not be bound by any decision they take. Under other laws, the creditors may have specific functions to perform with regard to the conduct of the proceedings, which may involve cooperation and coordination with the insolvency representative. The insolvency representative may be required to consult with creditors on those matters before taking its decision or the decision-making power may reside with creditors. Other functions required the creditors to oversee the acts and decisions of the insolvency representative. Some of the issues in respect of which creditors may have an interest may include some or all of the following: continuation of the business in liquidation; post commencement financing; verification of claims; compensation of professionals, including the insolvency representative; treatment of judicial proceedings to which the debtor was a party at the time of commencement; consideration and approval of a reorganization plan; appointing a committee or representatives of creditors; supervising the acts of the insolvency representative; distribution of assets; and consideration (and approval) of the insolvency representative's final report and accounting.

271. Where the insolvency representative is not bound to follow the decision of creditors, insolvency laws often provide that for certain acts the insolvency representative must seek the prior approval of the court, or that creditors may apply to the court to give binding instructions to the insolvency representative (or to seek replacement of the insolvency representative where the insolvency representative fails to meet its obligations or otherwise acts to the detriment of creditors). In the event of a dispute between the creditors and the insolvency representative, many laws give precedence to the decision at a meeting of creditors. A similar intention is found in the requirements for creditors to be consulted on any decisions that require court approval.

272. Whatever functions are to be performed by the creditors, it is desirable that an insolvency law clearly states whether the general body of creditors is required to undertake each of its specified functions, or whether certain functions are discretionary, and the manner in which creditors are to interact with the insolvency representative in the performance of those functions.

(ii) Creditor meetings

273. Many insolvency laws provide for the functions of creditors to be undertaken via general meetings of creditors (as opposed to meetings of a committee that might be appointed to undertake functions on behalf of the general body). As noted above (see Part two, chapter II.B), an insolvency law should require creditors to be notified (whether by personal notice, advertisement or some other means) of the commencement of insolvency proceedings and for that notification to include advice on a number of matters, including details of an initial meeting of creditors, to be convened by the court or the insolvency representative within a prescribed period of time after commencement (examples of time limits range from five days to one month from the date of commencement).

274. Insolvency laws take different approaches to subsequent meetings of the general body of creditors. Under a number of insolvency laws, the initial meeting is the only meeting of creditors that will take place. Under other laws further meetings are to be convened by the court or the insolvency representative for specific purposes, while yet other laws include provision for creditors or the insolvency representative, and in some limited cases the debtor, to convene meetings on an ad hoc basis, as required. Where the insolvency law allows creditors to convene a meeting, the law may include certain limitations on when a meeting can be called or conditions that must be fulfilled before a meeting can be called. These conditions may include the passing of a defined period of time after a certain step in the proceedings was to be taken, or upon the completion of defined acts or decisions of the insolvency representative or where the insolvency representative fails to act. Some laws also provide that only creditors holding a specified percentage of the total claims are entitled to call a meeting (examples include ten per cent of creditors by value, creditors with no less than 25 per cent of total claims or at least 25 per cent of unsecured claims). A further approach allows any interested party the right to apply to the court to summon a meeting of creditors.

275. It is desirable that all creditors have the right to be heard on matters to be discussed at a creditor meeting. Where a vote of the general body of creditors is required, it is desirable that an insolvency law establishes the relevant voting requirements and mechanisms. It may also be desirable for an insolvency law to provide for creditors to establish rules governing the conduct of creditor meetings where this would facilitate creditor participation, and where it would be appropriate to the role to be played by creditors in the proceedings.

(d) Creditor committee

276. [193] In some insolvency proceedings the formation of a creditor committee or the election of a creditor representative can provide a mechanism to facilitate creditor participation in the proceedings, whether liquidation or reorganization. A creditor committee (or similar form of creditor representation) may not be required in all insolvency cases, but may be appropriate where there is a very large number of creditors, where creditors have very diverse interests, or where other features of the case indicate that such an approach is desirable or necessary (e.g. to limit time and monetary costs). Some insolvency laws provide for creditors to determine whether or not they will appoint a committee, while other laws provide for the court to appoint a committee to help supervise the acts of the insolvency representative. Where a creditor committee is formed, it will be necessary to consider the extent to which the insolvency estate will pay the costs of the committee; some insolvency laws allow creditors to form unofficial committees which are not formally recognized by the court or the insolvency representative and whose costs are not reimbursed by the insolvency estate, and other laws provide that creditors may appoint a representative, but must bear the associated costs. A number of laws provide that the costs of the creditor committee are to be borne by the estate. This question is closely linked to the role of the committee, the extent to which the functions specified under the insolvency law to be performed by the creditors can be performed by a committee and the factors determining whether a committee is to be formed in any particular proceeding.

(i) Creditors that may be appointed to a committee

277. [199] Different approaches are taken to the composition of creditor committees. As an initial issue, an insolvency law may need to consider which creditors will be entitled to be appointed to a creditor committee. Some insolvency laws provide, for example, that only creditors whose claims have been admitted (by the court or the insolvency representative, depending upon the admission procedure) can be appointed, while other laws provide for appointment of a provisional committee, for which all creditors are eligible, until all claims have been verified and admitted. Other insolvency laws impose restrictions on the location of creditors who may serve on a creditors committee. [205] To ensure equality of treatment of creditors, however, it may be desirable for creditors such as those whose claims have only been provisionally admitted and foreign creditors to be eligible for appointment to the committee.

278. A second issue relates to the types of creditors to be represented. [199] Although creditor committees generally represent only unsecured creditors, some laws recognize that there may be cases where a separate committee of secured creditors is justified. Those systems base this approach on the fact that the interests of the different types of creditors do not always converge and the ability of secured creditors to participate in, and potentially affect, the outcome of decisions by the committee may not always be appropriate or in the best interests of other creditors.

279. [200] Other insolvency laws provide for both types of creditors to be represented on the same committee. The rationale of this approach is that since the creditor committee is responsible for participating in the decision-making process and for making important decisions, secured creditors should participate otherwise they are excluded from the making of important decisions which may affect their interests. A further approach may be for an insolvency law not to specify which creditors should be represented in a given case, but to allow creditors to collectively choose their own representatives on the basis of willingness to serve (to address the problem of creditor apathy which is not uncommon) and to provide for enlargement or reduction of the size of the committee as required. Where the types of creditors requiring representation are too diverse to accommodate their interests within a single committee, such as may be the case for special interest groups such as tort claimants and shareholders, an insolvency law could provide for different committees to represent different interests. It is desirable, however, that this mechanism only be used in special cases, in order to avoid unnecessary costs and the possibility of the creditor representation mechanism becoming unwieldy.

280. [201] The participation of shareholders or owners of the debtor and creditors related to the debtor may be controversial, especially where the creditor committee has the power to affect the rights of secured creditors or where the shareholders or owners are involved with the management of the debtor. There will be cases, however, where the shareholders have no direct knowledge of, or involvement with, the management of the debtor, such as where the shareholders are investors with no direct association with or access to management. In such cases, there may be compelling reasons for allowing the shareholders to participate through their own committee. Other creditors who may have a conflict of interest (such as competitors of the debtor who may have a personal interest with the potential to affect their impartiality in carrying out the functions of the committee) may also need to be excluded from participation in a committee in order to ensure that the committee is

able to perform its functions on behalf of the general creditor body impartially and independently.

281. [202] A similar question of participation may arise in respect of parties who purchase the claims of creditors. Such purchasers may be related to the debtor or may be third parties who have no particular interest in the business of the debtor. Third party purchases may give rise to concerns about access to sensitive, confidential information that may be of value in the secondary debt market, while related party purchases raise the question of whether the related party should be entitled to claim the original face value of the claim or only the amount actually paid for it (where there is a difference between the two), which may affect the ability to vote where it is directly related to the value of claims.

282. [203] To address any potential problem, an insolvency law could adopt the approach of stipulating which parties are not entitled to participate in a creditor committee or vote on particular matters, such as selection of an insolvency representative or approval of a reorganization plan.

(ii) Formation of a creditor committee

283. [204] Where the law provides for the formation of creditor committees, details of the manner in which the committee is to be formed, the scope and extent of its duties, its governance and operation, including voting eligibility and powers, quorum and conduct of meetings, as well as replacement and substitution of members are often also addressed. It may be desirable to include such provisions in an insolvency law not only to avoid disputes and ensure confidentiality, but also to provide transparent and predictable procedures.

284. [206] A number of different approaches are taken to appointing the members of the committee, which depend to a large extent on the functions to be performed by the particular committee. In many cases, it is the general body of creditors that appoints the committee, normally at the initial meeting of creditors, or upon the provision by the insolvency representative of preliminary information regarding the debtor. Appointment of the committee by creditors may encourage both creditor confidence and participation in the insolvency process. Some jurisdictions allow the court to appoint a creditors committee, either at its own instigation or upon application by creditors or the insolvency representative. The disadvantages of this approach may include perceptions of bias, and a lack of equity and transparency; creditors may not have confidence in a system that does not encourage or allow them to play a role in selecting their own representatives and it may not serve to overcome the widespread problems of creditor apathy. On the other hand, such an approach may serve to simplify the procedure for establishing a creditor committee and reduce the scope for disputes between creditors. The choice between these different approaches may depend upon the extent to which the court supervises the insolvency proceedings and is involved on a day-to-day basis, and the extent to which creditors are required to undertake an active role in performing functions that require more than the provision of advice to the insolvency representative.

285. [205] To facilitate administration and oversight of the committee, some insolvency laws specify the size of the committee—generally an odd number in order to ensure the achievement of a majority vote, and in some cases no more than three or five persons. Where the committee represents only unsecured creditors,

membership of the committee is sometimes limited to the largest unsecured creditors. These creditors can be identified by a number of means, including requiring the debtor to prepare a listing of its largest creditors. [207] To ensure that it fulfils its duty to fairly represent creditors, oversight of the committee may be desirable where the insolvency law provides for the committee to undertake a significant role and could be undertaken by the insolvency representative, or by the court.

(iii) Functions of a creditor committee

286. As a general proposition, a creditor committee will perform its functions on behalf of the general body of creditors and those functions will therefore be related directly to the functions of the general body of creditors. The powers and functions given to a creditors committee should not impair the rights of the creditors as a whole to participate or otherwise act in the insolvency proceeding. In general, insolvency laws provide for a creditors committee to advise, consult with or possibly supervise the insolvency representative, and [208] undertake a number of specific tasks including monitoring the progress of the case (which may include requiring the provision of information by the insolvency representative); consulting with other principals in the proceeding, especially an insolvency representative and the existing management of the debtor; and advising the insolvency representative on the wishes of the creditor body on issues such as the sale of significant assets and formulation of the reorganization plan. To perform its functions, the committee may require administrative and expert assistance. This can be addressed by providing that the committee can seek permission from the insolvency representative or the general body of creditors to hire a secretary and, if circumstances warrant, consultants and professionals. Some insolvency laws provide that such costs will be paid by the insolvency estate, while other laws provide that creditors must meet their own costs of participation in the insolvency process.

(iv) Liability of the creditor committee

287. [209] The committee's duty would be to the general body of creditors. It would not have any liability or fiduciary duty to the owners of the insolvent business. It may be desirable to require the committee to act in good faith and to provide that members of the committee would be immune from liability in respect of actions and decisions taken by them as members of the committee unless they were found to have acted improperly or to have breached a fiduciary duty to the creditors they represent. This might include, for example, deriving profit from the administration; or acquiring assets forming part of the estate without prior approval of the court. In considering the question of the liability of the committee, a balance may need to be struck between setting too high a level of responsibility which will promote creditor apathy and effectively discourage creditors from participating, and too low a level which may lead to abuse and prevent the committee from functioning efficiently as a representative body.

(v) Removal and replacement of members of the committee

288. An insolvency law may need to give some consideration to the grounds upon which removal of a member of the creditor committee might be justified and to establishing a mechanism for replacement. The procedure for such removal and

replacement may be related to the procedure for appointment of a creditor committee in the first instance, whether by the court or election by the general body of creditors. A mechanism for replacement of members of the committee will also be relevant where members of the committee resign or are unable to continue performing the required functions, such as in cases of serious illness or death.

(e) Voting of creditors

289. An insolvency law may need to consider distinguishing between the matters on which a vote of the general body of creditors is required and those matters on which a creditor committee may make a decision, as well as establishing the applicable voting requirements in each case. It may also need to consider what will constitute a valid meeting of a creditor committee in terms of number of members (or quorum) required to attend, although the need for such a provision may depend upon the functions to be performed by the committee.

290. [210] Where actions to be taken in the course of the proceedings will have a significant impact on the creditor body, it is desirable that all creditors (as opposed to just the creditor committee) are entitled to receive notice of, and to vote on, those actions. These actions may include voting to select the insolvency representative where an insolvency law provides creditors with this role; on approval of the reorganization plan; on other significant events such as sale of substantial assets; and post-commencement finance.

291. A number of different approaches can be taken with respect to achieving that vote, depending upon the nature of the matter to be decided. Some laws provide that voting should occur in person at a meeting of creditors, while other laws provide that where a large number of creditors are involved or where creditors are not local residents, voting may take place by mail or by proxy. It may also be desirable to recognize that voting may take place using electronic means.

292. [211] Different approaches are taken to the type of voting result that is required to bind creditors to different decisions, [212] with some insolvency laws distinguishing between different types of decisions to be made. More important decisions, such as approval of a reorganization plan, may require a vote that includes both a proportion of value of claims as well as a number of creditors (see Part two, chapter V). Some laws require a majority in value for most decisions and for decisions such as election or removal of the insolvency representative and hiring of particular professionals by the insolvency representative, a majority in value and number is required. Other laws provide that a simple majority is sufficient on issues such as election or removal of the insolvency representative. Some laws also distinguish between matters requiring the support of both secured and unsecured creditors; secured creditors will only participate in the vote on specified matters such as selection of the insolvency representative and matters affecting their security.

293. Jurisdictions also take a variety of approaches to establishing a voting mechanism for the committee. These approaches reflect those that are used for the general body of creditors. It is most important, however, that some rules be established to govern the decision-making of the creditor committee, including rules relating to majorities and voting.

(f) Resolution of disputes between the general body of creditors and the creditor committee

294. As noted above with regard to disputes with the insolvency representative, many insolvency laws give precedence to decisions made in a meeting of the general body of creditors. As the primary decision-making organ for creditors, express decisions of the general body of creditors should override decisions made on the same matter by a creditor committee.

(g) Confidentiality

295. As noted above (Part two, chapter IV.A and B), it is desirable that an insolvency law imposes obligations of confidentiality on both the debtor and the insolvency representative. For similar reasons, it may be appropriate to also consider the circumstances in which creditors should be required to observe confidentiality. In the course of the administration of an insolvency proceeding, creditors generally will be in a position to obtain significant amounts of information concerning the debtor and its business, much of which may be commercially sensitive. While the consequences of liquidation suggest that there may not be much opportunity for creditors to take unfair advantage of that information (or that harm to the debtor will result), that may not be true of reorganization, and there may be circumstances where creditors can use that information to affect the successful implementation of an agreed plan. For these reasons, it may be appropriate to impose on creditors an obligation of confidentiality that permits the use of information obtained in the course of the proceedings only for the purposes of administration of the proceedings, unless the court decides otherwise.

Recommendations

Classes of creditors

Purpose of legislative provisions

The purpose of provisions on classes of creditors is to: […].

Content of legislative provisions

(106) The insolvency law should clearly identify the different classes of creditors that will be affected by the insolvency law and the manner in which those classes will be treated under the law [in terms of claims, priority and distribution].

Participation of creditors in insolvency proceedings

Purpose of legislative provisions

The purpose of provisions on participation of creditors in insolvency proceedings is to:

(a) Establish the functions and responsibilities of the general body of creditors;

(b) Provide for the participation in insolvency proceedings of the general body of creditors by the appointment of a creditor committee;

(c) Provide a mechanism for the appointment of a committee;

(d) Establish the functions and responsibilities of the creditor committee.

Content of legislative provisions

General body of creditors [assembly of creditors]

(107) [(85)] The insolvency law should establish the powers and functions of the general body of creditors. These should include:

(a) Approval or rejection of a reorganization plan;

(b) [Involvement in] [advising on] issues referred by the insolvency representative, including advising on continuation of the business in liquidation, post-commencement financing, verification of claims, compensation of professionals, treatment of judicial proceedings to which the debtor was a party at the time of commencement, distribution of assets and […].

- *Voting of the general body of creditors*

(108) [(86)] The insolvency law should specify the matters on which a vote of the general body of creditors is required and establish the relevant voting requirements.

- *Right to be heard*

(109) [(87)] Creditors should have the individual right to be heard in the insolvency proceedings on matters relating to […].

- *Participation of secured creditors*

(110) [(90)] The insolvency law should clearly indicate the extent to which secured creditors [may] [should] participate in both liquidation and reorganization proceedings. Where secured creditors rely on secured assets to pay part or all of their claims, the insolvency law [may] [should] limit their participation in the proceedings to the extent that their claim is secured. Where secured creditors have surrendered their security to the insolvency representative, the insolvency law should enable them to participate in the proceedings to the same extent as ordinary unsecured creditors. Where a secured creditors claim is to be restructured under a reorganization plan, the secured creditor should be entitled to participate in the reorganization proceedings.

- Convening meetings of the general body of creditors

(111) Meetings of the general body of creditors may be convened [by the court] [by the insolvency representative] [at the request of creditors [*holding (specify a percentage of the total value of*) [unsecured] claims].

Creditor committee

(112) [(88)] The insolvency law should provide [a mechanism] for the general body of creditors to actively participate in the insolvency proceedings [such as] through a creditor committee. Where the interests and categories of creditors involved in the insolvency proceeding are diverse and participation will not be facilitated by the appointment of a single committee, the insolvency law may provide for the appointment of different creditor committees.

(113) Where the insolvency law provides for a creditor committee to be appointed the relationship between the general body of creditors and the creditor committee should be clearly stated. In particular, the insolvency law should specify: whether a committee is required in all insolvency cases, the distribution of functions and powers between the general body of creditors and the creditor committee, the mechanism for resolution of disputes between the general body of creditors and the creditor committee and […].

- *Creditors that may be appointed to a creditor committee*

(114) [(89)] The insolvency law should specify the categories of creditors that may or may not be appointed to the committee, including whether or not a creditor's claim must be admitted [whether provisionally or otherwise] before it is entitled to be appointed to a committee. The creditors who [may] [should] not be appointed to the creditor committee would include related persons such as creditors related to the debtor (whether personally or as a director, manager or advisor of the debtor) and creditors with a personal interest in the affairs of the debtor where that interest has the potential to affect the creditor's impartiality in carrying out the functions of the committee (e.g. a competitor of the debtor).

- *Mechanism for appointment to a creditor committee*

(115) [(91)] The insolvency law should establish the mechanism for appointment of the creditor committee. Different approaches may include selection of the creditor committee by the general body of creditors or appointment by the court or other administrative body.

- *Functions of a creditor committee*

(116) [(92)] The insolvency law should establish the powers and functions of the creditor committee including:

(a) In both liquidation and reorganization proceedings, a general advisory function, providing advice and assistance to the insolvency representative;

(b) A supervisory function with respect to development of the reorganization plan, the sale of significant assets and in other matters as directed by the court or determined in cooperation with the insolvency representative;

(c) The right to be heard in insolvency proceedings.

- *Employment and remuneration of professionals by a creditor committee*

(117) [(93)] The insolvency law should permit the creditor committee, subject to approval by [the court] [the general body of creditors], to employ and remunerate professionals that may be needed to assist the creditor committee to perform its functions.

- *Liability of members of a creditor committee*

(118) [(94)] The insolvency law should provide that members of the creditor committee are exempt from liability for their actions in their capacity as members of the committee unless they are found, for example, to have acted fraudulently.

- *Removal and replacement of members of a creditor committee*

(119) [(95)] The insolvency law should provide for removal and replacement of members of the creditor committee and specify the grounds, including [gross] negligence, [lack of the necessary skills], [incompetence or inefficiency].

- *Procedural rules for a creditor committee*

(120) [(96)] The insolvency law may provide for the establishment of rules to govern the performance of the functions and decision-making of the creditor committee, including rules relating to majorities and voting.

D. Institutional framework

296. An insolvency law is a part of an overall commercial legal system and is heavily reliant for its proper application not only on a developed commercial legal system, but also on a developed institutional framework for administration of the law. The choices made in developing or reforming an insolvency law will therefore need to be closely linked to the capacities of existing institutions. The insolvency system will only be effective if the courts and officials responsible for its implementation have the necessary capacity to provide the most efficient, timely and fair outcome to those for whose benefit an insolvency system exists. If that institutional capacity does not already exist, it is highly desirable that reform of the insolvency law is accompanied by institutional reform, where the costs of establishing and maintaining the necessary institutional framework are weighed against the benefits of providing a system that is efficient, effective and in which the public have confidence. Although a detailed discussion of the means by which this institutional capacity can be developed or enhanced is beyond the scope of this Guide, a number of general observations can be made.

297. In most jurisdictions, the insolvency process is administered by a judicial authority, often through commercial courts or courts of general jurisdiction or, in a few cases, through specialized bankruptcy courts. Sometimes judges have specialized knowledge and responsibility only for insolvency matters, while in other cases insolvency matters are just one of a number of wider judicial responsibilities. In a few jurisdictions non-judicial or quasi-judicial institutions fulfil the role that in other jurisdictions is played by the courts.

298. In designing the insolvency law it may be appropriate to consider the extent to which courts will be required to supervise the process and whether or not their role can be limited with respect to different parts of the process or balanced by the role of other participants in the process, such as the creditors and the insolvency representative. This is of particular importance where the insolvency law requires judges to deal quickly with difficult insolvency issues (which often involve commercial and business questions) and the capacity of the judiciary is limited, whether because of its size, a general lack of resources in the court system or a lack

of specific knowledge and experience of the types of issues likely to be encountered in insolvency.

299. To limit the role to be played by the court, an insolvency law can provide that the representative, for example, is authorized to make decisions on a number of issues, such as verification and admission of claims, the need for post-commencement funding, surrender of secured assets of no value to the estate, sale of major assets, commencement of avoidance actions, and treatment of contracts, without the court being required to intervene, except in the case of a dispute. Creditors also can be authorized to provide advice to, or to approve certain decisions of, the insolvency representative, such as approving the sale of important assets or obtaining post-commencement finance, without requiring the court to intervene, except in the case of dispute. An insolvency law can specify those procedures that will require court approval, such as the provision of a priority ranking above the rights of existing secured creditors to secure post-commencement finance.

300. The court's capacity to handle the often complex commercial issues involved in insolvency cases is often not only a question of knowledge and experience of specific law and business practices, but also a question of that knowledge and experience being current and regularly updated. To address the issue of judicial capacity, a special focus on the education and ongoing training of court personnel, not only of judges but also of clerks and other court administrators, will assist in supporting an insolvency regime that has the ability to respond effectively and efficiently to its insolvency caseload.

301. A further consideration related to the court's capacity to supervise insolvency cases is the balance in the insolvency law between mandatory and discretionary components. While mandatory elements, such as automatic commencement or automatic application of the stay, may provide a high degree of certainty and predictability for debtor and creditors as well as limiting the matters requiring consideration by the courts, it may also lead to rigidity if there are too many of these type of elements. A discretionary approach allows the court to weigh facts and circumstances, taking into account precedent, community interests, and those of persons affected by the decision and market conditions. It may also impose a burden on the court where it does not have the knowledge or experience required to weigh these considerations or the resources to respond in a timely manner. Where the insolvency law provides for confirmation of a reorganization plan by the court, for example, it is not desirable to ask the court to undertake complex economic assessments of the feasibility or desirability of the plan, but rather to limit its consideration to the conduct of the approval process and other specified issues. Where an insolvency law requires the exercise of discretion by a decision maker, such as a court, it is preferable that adequate guidance as to the proper exercise of that discretion is also included, particularly where economic or commercial issues are involved. This approach is consistent with a general objective of an insolvency regime of transparency and predictability.

302. The adequacy of the legal infrastructure and, in particular, the resources available to courts dealing with insolvency cases, may be a significant influence on the efficiency with which insolvency cases are handled and the length of time required for insolvency proceedings. This may be a relevant consideration in deciding whether the insolvency law should impose time limits for the conduct of

certain parts of the process. If the court infrastructure is not able to respond to the demands placed upon it in a timely manner to ensure that time limits are observed by the parties and the insolvency process moves quickly along, the inclusion of such provisions in the law will not achieve the goal of an effective and efficient insolvency regime. Procedural rules will also be of importance to the conduct of cases and well-developed rules will assist courts and the professionals handling insolvency cases to provide an effective and orderly response to the economic situation of the debtor, minimizing the delays that can result in diminution in value of the debtor's assets and impair the prospects of successful insolvency proceedings (whether liquidation or reorganization). Such rules will also assist in achieving a degree of predictability and uniformity of treatment from one case to the next.

303. Implementing an insolvency system depends not only on the court, but also on the professionals involved in the insolvency process, whether they are insolvency representatives, legal advisers, accountants, valuation specialists or other professional advisers. The adoption of professional standards and training may assist in developing capacity. It may be an appropriate to assess which insolvency functions are truly public in nature and should be performed in the public sector in order to ensure the level of trust and confidence required to make the insolvency system effective, and those functions which can be performed by the creation of adequate incentives for private sector participants in the insolvency process. The insolvency representative might be one example.

Recommendations

[NOTE TO THE WORKING GROUP: The Working Group may wish to consider whether recommendations on the institutional framework required for an effective and efficient insolvency regime should be added to the Guide and if so, what those recommendations should include.]