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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-C appear in documents A/CN.9/WG.V/WP.63/Adds.5-7; Chapter III.E-F and chapters IV-VII appear in subsequent addenda]

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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)

III. Treatment of assets on commencement of insolvency proceedings

D. Treatment of contracts

1. Introduction

118. [86] As an economy develops, more and more of its wealth is likely to be contained in or controlled by contracts, rather than contained in land. As a result, the treatment of contracts in insolvency is of overriding importance. There are two overall difficulties in developing legal policies in that regard. The first difficulty is that contracts are unlike all other assets of the insolvency estate in that usually they are tied to liabilities or claims. That is, it is often the case that the estate must perform or pay in order to enjoy the rights that are potentially valuable assets. The result is that difficult decisions must be made about the treatment of a contract so as to produce the most value for the estate. [89] A second difficulty is that contracts are of many different types. They include simple contracts for the sale of goods; short-term or long-term leases of land or of personal property; and immensely complicated contracts for franchises or for the construction and operation of major facilities, among many others. Additionally, the debtor could be involved in the contract as buyer or seller, lessor or lessee, licensor or licensee, provider or receiver and the problems presented in insolvency may be very different when viewed from different sides.

119. [87] Achieving the objectives of maximizing the value of the estate and reducing liabilities and, in reorganization, enabling the entity to survive and continue its affairs to the maximum extent possible in an uninterrupted manner may involve taking advantage of those contracts that are beneficial and contribute value, and rejecting those which are burdensome, or those where the ongoing cost exceeds the benefit of the contract. As an example, in a contract where the debtor has agreed to purchase particular goods at a price which is half the market price at the time of the insolvency, obviously it would be advantageous to the insolvency representative to continue to purchase at the lower price and sell at the market price. The counterparty would naturally like to get out of what is now an unprofitable agreement, but in many systems it will not be permitted to do so, although it may be entitled to an assurance that it will be paid the contract price in full. In many examples, continuation of the contract will be beneficial to both contracting parties, not just to the debtor.

120. [88] Deciding how contracts are to be treated in insolvency raises an initial question of the relative weight to be attached to upholding general contract law in insolvency on the one hand and the factors justifying interference with those established

contractual principles on the other. There are a number of competing interests which may need to be balanced. These include the extent to which public policy goals outweigh the need for predictability and the particular social concerns raised by some types of contracts such as labour contracts (see below); the effect of interfering with the terms of unperformed contracts on the predictability of commercial and financial relations, and on the cost and availability of credit (the wider the powers to continue [adopt] or reject contracts in insolvency, the higher the cost and the lower the availability of credit is likely to be); as well as the extent to which interfering with contracts will enhance the recycling of economic assets.

121. [88] Where the insolvency law adopts the approach of permitting interference with general contractual principles, further considerations are the extent of the interference that is permitted and the types of contracts that can be affected. [para 84] It is almost inevitable that at the commencement of insolvency proceedings, the debtor will be a party to at least one contract where the debtor and the counterparty have remaining obligations to be performed other than the payment of money, such as the contract price for goods delivered. [85] No special rules are required for the situation where only one party has not fully performed its obligations. If it is the debtor that has not fully performed, the other party will have a claim for performance or damages which it can submit in the insolvency (see Part two, chapter VI.A). If it is the counterparty that has not fully performed its obligations, the insolvency representative can demand performance or damages from that party. However, where both parties have not fully performed their obligations, it is a common feature of many insolvency laws that in defined circumstances, those contracts will continue or can be rejected (or possibly assigned, although this is not widely permitted). Typically, the insolvency representative is charged with making this evaluation. In some jurisdictions, court approval is also required.

122. [88] As to the types of contracts to be affected, a common solution is for insolvency laws to provide general rules for all kinds of contracts and exceptions for certain special contracts. The ability to reject labour contracts, for example, may need to be limited in view of concerns that liquidation can be used as a means of expressly eliminating the protections afforded to employees by such contracts. Other types of contracts requiring special treatment may include financial market transactions (see Part two, chapter III.F) and contracts for personal services, where the identity of the party to perform the agreement, whether the debtor itself or an employee of the debtor, is of particular importance.

2. Continuation [adoption]

123. [95] In reorganization, where the objective of the proceedings is to enable the entity to survive and continue its affairs to the extent possible, the continuation of contracts that are beneficial or essential to the business and contribute value may be crucial to the success of the proceedings.

124. [100] In liquidation, the desirability of contracts continuing after commencement of proceedings is likely to be less important than in reorganization, except where the contract may add value to the business or to a particular asset or promote the sale of the business as a going concern. A lease agreement, for example, where the rental is below market price and the remaining term is substantial, may prove central to any proposed sale of the business or may be sold to produce value for creditors.

(a) Automatic termination clauses

125. [96] Many contracts include a clause providing that commencement of insolvency proceedings or other indication of financial distress constitutes an event of default that gives the counterparty an unconditional right, for example, of termination or acceleration, or some other right. Some laws uphold the validity of these clauses for the benefit of the estate and where the insolvency representative wants a contract to continue after commencement of proceedings, this will only be possible if the counterparty does not elect, or can be persuaded not to elect, to terminate or accelerate the contract. In these corcumstances, where a counterparty can terminate a contract, an insolvency law may provide a mechanism that can be used to persuade the counterparty to allow the contract to continue, such as establishing a priority for payment for services provided after commencement of the proceedings (in some insolvency laws this may exist as a general provision which typically treats costs incurred after the commencement of proceedings as a first priority).

126. [97] The approach of upholding these types of termination clauses may be supported by a number of factors including: the desirability of respecting commercial bargains; the need to prevent the debtor from selectively performing contracts which are profitable and cancelling others (an advantage which is not available to the innocent counterparty); the effect on financial contract netting of not upholding an automatic termination provision; the belief that since an insolvent business will generally be unable to pay, delaying the termination of contracts potentially only increases existing levels of debt; the need for creators of intellectual property to be able to control the use of that property; and the effect on the counterparty's business of termination of a contract with respect to an intangible.

127. [98] Another approach provides that the insolvency representative can continue or adopt a contract over the objection of the counterparty, that is, any event of default, such as commencement of insolvency proceedings, which would give rise to a right to terminate or accelerate the contract is overridden by operation of the insolvency law. Permitting these termination and acceleration clauses to be overridden in reorganization proceedings may be crucial to the success of the proceedings where, for example, the contract is a critical lease or involves the use of intellectual property embedded in a key product. It may also enhance the earnings potential of the business; reduce the bargaining power of an essential supplier; capture the value of the debtor's contracts for the benefit of creditors and assist in locking all creditors into the reorganization. Where an insolvency law provides that termination clauses can be overridden, creditors may be tempted to take pre-emptive action to avoid that outcome by terminating the contract on some other ground before the application for insolvency proceedings is made (assuming a default by the debtor other than one triggered by commencement of the proceedings). Such a result may be mitigated by providing that the insolvency representative has the power to reinstate those contracts, provided both pre- and post-commencement obligations are fulfilled.

128. [101] In liquidation, the arguments in favour of overriding termination clauses include the need to keep the business together to maximize its sale value or to enhance its earnings potential; to capture the value of the contract for the benefit of all creditors rather than forfeiting it to the counterparty; and the desirability of locking all parties into the final disposition of the business.

129. [99] Although some jurisdictions have implemented provisions allowing termination clauses to be overridden, these provisions have not yet become a general

feature of insolvency laws. There is an inherent tension between promoting the debtor's survival, which may require the preservation of contracts, and injecting unpredictability and extra cost into commercial dealings by creating a variety of exceptions to the general rules. While this issue is one which may require a careful weighing of the advantages and disadvantages there are, nevertheless, circumstances where the ability of the insolvency representative to ensure that a contract continues will be crucial to the conduct and successful implementation of reorganization and also, but perhaps to a lesser extent, liquidation where the business is to be sold as a going concern. Any negative impact of a policy of overriding termination clauses can be balanced by providing compensation to creditors who can demonstrate that they have suffered damage or loss as a result of the contract continuing after commencement of proceedings.

(b) Procedure for continuation of contracts

130. [92] Insolvency laws adopt different approaches to continuation, or in some cases adoption, of contracts. Under some laws, contracts are unaffected by the commencement of insolvency proceedings so that contractual obligations remain binding and the general rules of contract law will continue to apply unless the insolvency law expressly provides for different rules to be applied, as in the case of automatic termination clauses (see above). [91] Some insolvency laws, however, require the insolvency representative to make a decision as to whether the contract is required and will continue, and set a deadline by which this decision must be taken. Failure to act within the specified time results in the contract being treated as rejected. Where this approach is adopted, a distinction between liquidation and reorganization might be made. In liquidation, it may be possible to provide for contracts to be automatically terminated unless the insolvency representative takes action within a specified time period to preserve a contract. In reorganization, however, more flexibility might be required to avoid a situation where the failure to take a timely decision deprives the estate of a contract that might be crucial for the procedure. One disadvantage of this approach is that in practice there may be many cases where no decision as to the contract can be taken because the contract cannot be performed, and to require an explicit choice to be made on each contract could result in an excessively costly and cumbersome procedure.

131. [92] Whatever rules are adopted with respect to the continuation of contracts, it is desirable that any rights of the insolvency representative should be limited to the contract as a whole, thus avoiding a situation where the insolvency representative could choose to continue or adopt certain parts of a contract and reject others. It is also desirable that the insolvency representative's power with respect to contracts is limited to the relevant types of contracts that are known to the insolvency representative or the court (where the court is involved in making determinations with respect to contracts). If this limitation is not adopted, the consequences of failure to take a decision with respect to a contract the existence of which is not known to the insolvency representative might lead to claims for damages and possible professional liability.

(c) Continuation of contracts where the debtor is in default

132. [93] Where the debtor is in default under a contract at the time of the application for insolvency, the policy issue is whether it is fair to require the counterparty to continue to deal with an insolvent debtor when there was already a pre-insolvency default. Some insolvency laws require, as a condition of a contract continuating, that the insolvency representative cure any defaults under the contract and provide assurance as to future performance by providing, for example, a bond or guarantee. Other insolvency laws do not

require past defaults to be cured, but may impose restrictions as to the circumstances in which this approach is possible, for example, contracts which can be divided into severable units, such as contracts for the supply of utilities. The insolvency representative may be required to give assurances of future performance and in some cases accept personal liability in the event of future default.

(d) Claims arising from continuing contracts

133. [94] Contracts that continue after commencement are treated as ongoing post-commencement obligations of the debtor that must be performed. Claims arising from the performance of the contract after the commencement of insolvency proceedings are treated in a number of insolvency laws as an administrative expense (see Part two, chapter VI.A) as opposed to an unsecured claim and given priority in distribution. Since the granting of such a priority constitutes a potential risk for other creditors (who will be paid after the priority creditors), it is desirable that only contracts that will be profitable or essential to the continued operation of the debtor continue after commencement of insolvency proceedings. Other insolvency laws provide no priority for such claims and they will rank with other unsecured claims.

(e) Amendment of continuing contracts

134. [88] A further issue to be considered is the circumstances in which an insolvency representative may alter the terms and conditions of contracts that continue after commencement. Where a contract continues, the terms and conditions of the contract must be respected. As a general principle, the insolvency representative will have no greater rights in respect of amendment of the contract than the debtor itself would normally have. This will require the insolvency representative to negotiate any amendment with the counterparty, and any modification without the consent of that other party, will constitute a breach of contract for which the counterparty may claim damages.

(f) Exceptions to the power to continue contracts

135. [102] Exceptions to the power of the insolvency representative to decide a contract should continue generally fall into two categories. In respect of the first, where the insolvency representative has the power to override automatic termination provisions, specific exceptions may be made for contracts such as short-term financial contracts (e.g. swap and futures agreements – see Part two, chapter III.F). The second category relates to those contracts where, irrespective of how the insolvency law treats automatic termination provisions, the contract cannot continue because it provides for performance by the debtor or an employee of the debtor of irreplaceable personal services (the contract may involve, for example, particular intellectual property, services involving a partnership agreement, provision of services by a person with highly specialised skills, or by a named person with a particular skill).

3. Rejection

136. [103] For the general reasons discussed in the introduction above, it is desirable that an insolvency representative has the power to reject a contract in which both parties have not fully performed their obligations. [91] It is also desirable that any right to reject a contract should be limited to the contract as a whole, thus avoiding a situation where the insolvency representative could choose to continue certain parts of a contract and reject others.

137. [107] In reorganization, the prospects of success may be enhanced by allowing the insolvency representative to reject burdensome contracts, such as those contracts where the cost of performance is higher than the benefits to be received or, in the case, for example, of an unexpired lease, the contract rate exceeds the market rate.

(a) Rejection procedure

138. [104] As in the case of continuation of contracts different mechanisms may be used to reject a contract. Many laws link continuation and rejection in a common procedure which provides, for example, that the insolvency representative is required to take action with respect to a contract, such as by providing notice to the counterparty that the contract is to continue or be rejected. Some laws require the notice to be given within a specified period of time. Unless this time limit is included, this approach may not achieve the key objectives of certainty, predictability and efficient progress of the proceedings if the insolvency representative does not take timely action and allows the matter to continue unresolved for some time. Where the contract in question involves an ongoing service, failure by the insolvency representative to act may also lead to the accrual of unnecessary expense (e.g. rent for real or personal property which is leased by the debtor can be a significant administrative cost if a lease is not promptly terminated), or to the provision of an essential service being terminated (where the insolvency representative is required to promptly decide that a contract should continue).

139. [105] Under a second approach the contract may be regarded as automatically rejected if the insolvency representative does not decide, within a specified time period, that it should continue. The time period may be longer in reorganization than in liquidation. This approach is aimed at ensuring certainty for both parties. It requires the insolvency representative to take timely action with respect to contracts outstanding at the time of commencement and offers the counterparty some certainty as to the continued existence of the contract within a reasonable period after commencement. Some laws also provide that the counterparty can request the insolvency representative to make a decision on a particular contract within a specified time or apply to the court to require that decision to be made; where no decision is made in those circumstances, the contract may be treated as rejected.

140. [108] As noted above with respect to continuation, it may be appropriate to draw a distinction between liquidation and reorganization in terms of providing for a default position that a contract is rejected. While in liquidation it may be reasonable to assume that the failure of the insolvency representative to take a decision with respect to a contract would most likely imply a decision to reject, the same assumption may not always be appropriate in reorganization. In reorganization, it may be appropriate to allow the insolvency representative to make a decision as to rejection up to the time of approval of the reorganization plan, provided that any benefit received under the contract is paid for up to the time of rejection as an administrative expense and that the counterparty has the

ability to compel an earlier decision where it is required or desired. It is desirable that treatment of specific contracts is addressed clearly in the plan, with perhaps a provision that contracts not so addressed should be treated as automatically rejected on approval of the plan.

(b) Effect of rejection on the counterparty

141. [106] Pending continuation or rejection of a contract, it is desirable that the insolvency estate be required to pay for any benefits received under the contract. Where a contract is rejected, the counterparty is excused from performing the remainder of the contract and the only serious issue to be determined is calculation of the unsecured damages that result from the rejection. The counterparty becomes an unsecured creditor with a claim equal to that amount of damages. Where a contract has been performed for a period of time during the insolvency proceedings before being rejected, the counterparty may have claims both for the period before rejection (which may rank as an administrative claim)[1] and for the damages resulting from the rejection. Where the contract continues, both the estate and the counterparty will be obliged to perform the terms of the contract.

(c) Exceptions to the power to reject

142. [109] Irrespective of the extent of the rejection powers given to an insolvency representative, exceptions may be needed for certain contracts. One important exception to the power to reject is labour contracts (see Part two, chapter III.D.6) and certain financial contracts (see Part two, chapter III.F). A similar limitation may appropriately be applied to the case of agreements where the debtor is a lessor or franchisor, or a licensor of intellectual property and termination of the agreement would end or seriously affect the business of the counterparty, particularly where the advantage to the debtor may be relatively minor.

4. Leases

143. Some insolvency laws include specific provisions on unexpired leases. Under some laws, a lease of which the debtor is the lessee can be rejected without reference to the expiry date of the lease, provided the notice periods in the law or the lease are observed. Rejection would give rise to a claim by the lessor for compensation for premature termination. Where the debtor is a lessee and its lease is to continue, it may be appropriate for certain conditions to be imposed on the insolvency estate, such as that the insolvency representative must cure any default, provide compensation for any harm arising from such a default and provide assurance as to future performance under the lease. [109] It may also be desirable to set a ceiling on damages claimed by the lessor (which may be a monetary amount or a specified period of time in respect of which damages may be payable) so that the claim under a long-term lease does not overwhelm the claims of other creditors. Lessors ordinarily will have the opportunity to mitigate losses by re-letting the property.

5. Assignment

144. [110] The ability of the insolvency representative to elect to assign contracts notwithstanding insolvency-triggered termination provisions or restrictions on transfer contained in the contract can have significant benefits to the estate, and therefore to the

[1] See Part two, chapter VI.C on ranking of claims.

beneficiaries of the proceeds of distribution following liquidation or as part of a reorganization. [111] While the ability to assign is considered of critical importance to the liquidation proceedings of some countries, in other countries it is entirely foreign and is precluded. [110] There may be circumstances, such as where the contract price is lower than the market value, where rejection of the contract may result in a windfall for the counterparty. If the contract can be assigned, the insolvency estate rather than the counterparty will benefit from the difference between the contract and market prices.

145. [111] However, providing for assignment of a contract against the terms of the contract may undermine the contractual rights of the counterparty and raise issues of prejudice, especially where the counterparty has little or no say in the selection of the assignee, [97] and the undesirability of compelling the transfer of a contract to a transferee who may not be known to the counterparty or with whom the counterparty may not wish to do business. Different approaches are taken to this issue. Some insolvency laws specify that non-assignment clauses are made null and void by the commencement of insolvency proceedings. Other insolvency laws leave the matter to general contract law; if the contract contains a non-assignment clause then the contract cannot be assigned unless the agreement of the counterparty or of all parties to the original contract is obtained. Some laws also provide that if the counterparty does not consent to assignment, the insolvency representative may assign with permission from the court if it can be shown that the counterparty is withholding consent unreasonably or if the insolvency representative can demonstrate to the counterparty that the assignee can adequately perform the contract. The insolvency representative is then free to assign the contract for the benefit of the estate.[2]

146. [112] Irrespective of the powers of the insolvency representative to assign contracts, some contracts cannot be assigned because they require the performance of irreplaceable personal services or because assignment is prevented by the operation of law. Some countries, for example, prevent the assignment of government procurement contracts.

6. General exceptions to the power to continue [adopt], reject and assign contracts

147. [112] A number of specific exceptions to the powers discussed in this section have been mentioned above. However, an insolvency law may need to consider general exceptions for some types of contracts not only to these powers but also to the application of other provisions of the insolvency law. Exceptions relating to financial contracts, netting and set-off are discussed in Part two, chapter III.F.

- Labour contracts

148. [113] One important exception to the powers discussed in this section is that of labour contracts. Although particularly relevant to reorganization, such contracts are also relevant in liquidation where the insolvency representative is attempting to sell the entity as a going concern. A higher price may be obtained if the insolvency representative is able to terminate onerous labour contracts or to achieve necessary downsizing of the labour force of the debtor. However, the relationship between employee and employer raises some of the most difficult questions in insolvency law. It is not simply the contract itself, which in essence is a pending contract like any other, but the usually mandatory provisions of non-insolvency law that protect the position of employees. These may relate to, for

[2] This approach is consistent, for example, with the approach taken in the UNCITRAL Convention on the Assignment of Receivables in International Trade (2001), article 9.

example, unfair dismissal; minimum rates of pay; paid leave; maximum work periods; maternity leave; equal treatment and non-discrimination. The difficult question is generally the extent to which these provisions will impact upon the insolvency, raising issues that are much broader than termination of the contract and priority of monetary claims in respect of unpaid wages and benefits (see Part two, chapter VI.A and C). For these reasons, a number of countries have adopted special regimes to deal with the protection of employees' claims in insolvency and, in order to avoid insolvency proceedings being used as a means of eliminating employee protection, specifically limit the insolvency representative's ability to reject labour contracts. This approach may include limiting the use of the powers to certain specified circumstances such as where the employees remuneration is excessive in comparison to what the average employee would receive for the same work. In some countries the law provides for employees to follow the business in case of sale as a going concern in both liquidation and reorganization, in others only in reorganization.

149. [114] To enhance the transparency of the insolvency regime, it is desirable that the limitations on the powers of the insolvency representative to deal with these types of contracts are stated clearly in the insolvency law.

7. Post-commencement contracts

150. [114] A second category of contracts in insolvency are those entered into after the insolvency has commenced. In reorganization and where the business is to be sold as a going concern in liquidation, there will often be a need for contracts to be entered into (both in the ordinary course of business and otherwise) to maintain the business as a going concern and enable it to continue earning for the ultimate benefit of creditors. These contracts are generally regarded as post-commencement obligations of the estate and [90] breach of a contract in that category is usually a first claim on the available funds and therefore is paid in full as an expense of the insolvency administration (see Part two, chapter VI.C).

Recommendations

Purpose of legislative provisions

The purpose of provisions on treatment of contracts is to:

(a) establish the manner in which contracts, under which both ~~that have not or not fully been performed by either~~ the debtor and its counterparty have not yet fully performed their respective obligations, should be addressed in the insolvency law, including the relationship between the insolvency law and general contract law, with the objective of maximizing the value and reducing the liabilities of the estate;

(b) define the scope of the powers to deal with these contracts and the situations in which [and by whom] these powers may be exercised;

(c) identify the types of contracts that should be excluded from the exercise of these powers.

Content of legislative provisions

(52) [(41)] The insolvency law should address the treatment of contracts under which both ~~that have not or not fully been performed by either~~ the debtor and its counterparty have not yet fully performed their respective obligations.

Automatic termination clauses

(53) [(42)] The insolvency law [may] [should] render unenforceable [as against the insolvency representative] any contract provision that would provide a right to terminate a contract upon, or identify as an event of default:

(a) an application for commencement, or commencement, of insolvency proceedings;
(b) the appointment of an insolvency representative;
(c) the fact that the debtor satisfies the criteria for commencement of insolvency proceedings; or
(d) indications that the debtor is in a weakened financial position.

Continuation

(54) [(43)] The insolvency law should provide that the insolvency representative can [decide to] continue a contract where continuation would be beneficial to the insolvency estate.[3]

Where a continued contract is subsequently breached

(55) [(45)] Where a contract continues after commencement of proceedings, the insolvency law should provide that all terms of the contract are enforceable (except automatic termination clauses as provided in recommendation (53)) and damages for the subsequent breach of that contract by the insolvency representative should be payable as an expense of administering the estate.

Continuation of contracts where the debtor is in breach

(56) [(46)] Where the debtor is in default under a contract at the time of commencement of proceedings, and the insolvency representative seeks to continue that contract, the insolvency law may take different approaches to the issue of curing the breach:

(a) the insolvency representative may have the power to [decide to] continue that contract, provided the default [is] [is capable of being] cured and the non-breaching counterparty is returned to the position it was in before the breach, and the insolvency representative gives appropriate assurances as to the [debtor's][insolvency estate's] ability to perform under the continued contract;

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[3] Provided the automatic stay on commencement of proceedings applies to prevent termination (pursuant to an automatic termination clause) of contracts with the debtor, all contracts should remain in place to enable the insolvency representative to consider the possibility of continuation.

[(b) the insolvency representative may have the power to [decide to] continue certain contracts [for example, those that can be divided into severable parts, such as for the provision of utilities] without having to cure the breach, provided the insolvency representative gives assurance as to satisfaction of post-commencement claims arising from the contract. The counterparty [should submit][will have] a pre-commencement claim in respect of the default.]

Rejection

(57) [(47)] The insolvency law should provide that the insolvency representative can [decide to reject a contract that is burdensome[4] to the insolvency estate.

(58) [(44)] In the period after the commencement of an insolvency proceeding, and before a contract is rejected, the insolvency law should provide that if the counterparty has performed to the benefit of the insolvency estate, the benefits conferred upon the insolvency estate pursuant to the contract are payable as an expense of administering the estate.[5]

(59) Where a contract is rejected, the insolvency law should provide for the counterparty to be notified of the rejection and of its rights in respect to making a claim (in particular the time in which the claim should be made).

(60) [(48)] Where a contract is rejected, the insolvency law should provide that the rejection gives rise to a [ordinary unsecured] [pre-commencement] claim for the damages arising from the rejection, which would be determined in accordance with the general rules on damages. Claims relating to the rejection of a long-term contract may be limited by the insolvency law.

(61) [(49)] Where the insolvency representative decides to reject a contract, the insolvency law should indicate the time at ~~date on~~ which the rejection will be effective.

Timing of continuation and rejection

(62) [(50)] The insolvency law may provide a time limit within which the insolvency representative is to decide to continue (where the insolvency law requires a specific decision for a contract to continue)or reject a contract, which time period may be extended by the court. The insolvency law may specify the consequences of the failure of the insolvency representative to act.

(63) [Notwithstanding recommendation (62),] the insolvency law should permit a counterparty to request the insolvency representative to take prompt action to make a decision with respect to a contract where the counterparty can demonstrate prejudice as a consequence of the delay.

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[4] The insolvency law may establish the circumstances in which an asset may be regarded as burdensome, including [51] where the assets have a negative or insignificant value; where the assets are not essential to a reorganization; where the asset is burdened in such a way that retention would require excessive expenditure that would exceed the proceeds of realization of the asset or give rise to an onerous obligation or a liability to pay money; or where the asset is unsaleable or not readily saleable.

[5] See Part two, chapter VI.C.

Assignment of contracts

~~*Variant A*~~

[(64) [(51)] The insolvency law need not provide rules relating to assignment of contracts if this issue is addressed by other law, such as general contract law, and it is considered that such issues should be determined by the application of that other law.]

(65) [(52)] Where it is considered desirable to include special provisions relating to assignment of contracts in the insolvency law, the insolvency law might provide that the insolvency representative can [decide to] assign a contract, notwithstanding restrictions in the contract.

(66) [(53)] Where the counterparty objects to assignment of a contract, the insolvency law may provide that the court can nonetheless approve the assignment [if] [provided]:

(a) the assignee can perform the contractual obligations;
(b) the counterparty [does not suffer unreasonable harm as a result of] [is not disadvantaged by] the assignment; [and]
(c) the assignment is necessary for [or of benefit to] the reorganization of the debtor or the sale of the debtor's business as a going concern in liquidation.

~~*Variant B*~~

~~(51) The insolvency law [may][should] provide that the insolvency representative can [elect to] assign a contract that has been continued.~~

~~(52) Where the counterparty objects to assignment of a contract, the insolvency law may provide that the court can nonetheless approve the assignment [if] [provided]:~~

~~(a) the assignee can perform the contractual obligations;~~
~~(b) the counterparty [does not suffer unreasonable harm as a result of] [is not disadvantaged by] the assignment;~~
~~(c) the assignment is necessary for the reorganization of the debtor.~~

Special treatment of certain contracts

(67) [(54)] The insolvency law may provide special rules for the treatment of labour, financial, intellectual property and […] contracts.[6]

[6] For treatment of financial and related contracts, see Part two, chapter III.F.

~~*Review of decisions concerning treatment of contracts*~~

~~(55) The insolvency law should permit interested parties to seek judicial review of decisions taken by the insolvency representative with respect to continuation and rejection. Grounds for review may include: […].~~[7]

Post-commencement contracts

(68) The insolvency law should provide that contracts entered into in the ordinary course of business after the commencement of insolvency proceedings will be regarded as post-commencement obligations of the insolvency estate. Claims arising from those contracts should be treated as an administrative expense.

~~[7] NOTE TO THE WORKING GROUP: The Working Group may wish to consider whether this type of provision should be included under each topic heading (see for e.g. recommendations (64), (83)) or as a general provision perhaps under chapter IV, section B on "The Insolvency Representative" along the following lines:~~

~~The insolvency law need not provide rules relating to the right of interested parties to seek review of decisions taken by the insolvency representative in the administration of the proceedings if that right to review exists under other law and it is considered that that issue should be determined by the application of that other law. Where it is considered desirable for reasons of clarity and transparency to include special provisions in the insolvency law, the insolvency law might provide also the grounds upon which such a review might be sought.~~