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CROSS-BORDER INSOLVENCY

Note by the Secretariat

Report on UNCITRAL - INSOL Colloquium on Cross-Border Insolvency

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INTRODUCTION

1. At the UNCITRAL Congress "Uniform Commercial Law in the 21st Century", held in conjunction with the twenty-fifth session (1992), it was proposed that the Commission should consider undertaking work on international aspects of bankruptcy. Consequent to that decision, the Secretariat presented to the Commission at its twenty-sixth session (1993) a note on cross-border insolvency, outlining various legal issues that might give rise to problems due to a lack of harmony among national laws (A/CN.9/378/Add.4). That note also provided a brief description of previous work at the international level towards harmonization of laws in the area. The prevailing view at the last session was that, despite concerns about the feasibility of a project to harmonize rules on international aspects of insolvency, the practical problems caused by the disharmony among national laws governing cross-border insolvencies warranted further study of legal issues in cross-border insolvencies and possible internationally acceptable solutions. The Secretariat was requested to prepare for a future session of the Commission an in-depth study on the desirability and feasibility of harmonized rules of cross-border insolvencies, a study that would consider which aspects of cross-border insolvency law lent themselves to harmonization and what might be the most suitable vehicle for harmonization (A/48/17, paras. 302-306).

2. As an initial step in gathering information for the feasibility assessment requested by the Commission, the Secretariat, with the co-sponsorship and organizational assistance of INSOL International, organized a Colloquium on Cross-Border Insolvency (Vienna, 17-19 April 1994). INSOL is an international association of practitioners from professions that participate in cross-border insolvency cases. The Colloquium was designed in particular to provide a forum for a dialogue among insolvency practitioners from various regions that have been exposed first-hand to the practice of cross-border insolvency, as well as being involved in efforts that have been made to date in the direction of harmonization of rules. As such, the Colloquium was geared to enabling the Commission to assess from a practical standpoint the desirability and feasibility of any future work that it might consider undertaking in this area. The approximately 90 participants from various countries included lawyers, chartered accountants, bankers, and judges that have presided over notable cross-border insolvency cases, as well as representatives of interested ministries of a number of Governments and of international organizations, such as INSOL and Committee J of the Section on Business Law of the International Bar Association (IBA). The main speakers included judges and practitioners that have had significant experience in cross-border insolvency cases, as well as individuals and representatives of organizations that have spearheaded international and regional harmonization efforts.

3. The present note presents an outline of the views and perspectives that were exchanged at the Colloquium, including a summary of possible directions and stages of work by the Commission that were indicated by the exchange of views and information that took place at the Colloquium.

DISCUSSION OF PREVAILING LEGAL ENVIRONMENT

A. General remarks

4. The view was widely shared at the Colloquium that the practical significance of legal aspects of cross-border insolvency would continue to grow, parallel to the ongoing expansion in multi-national economic activity. Emphasis was placed on the corresponding need to develop legal mechanisms for limiting the extent to which, in the event of insolvency in a cross-border context, disparities in and conflicts between national laws created unnecessary obstacles to the achievement of the basic

economic and social objectives of insolvency proceedings. Those objectives included, generally, protecting the rights and interests of creditors, employees, and debtors. In more specific terms, the legal rules applied in cases of cross-border insolvency should facilitate the rehabilitation of businesses that, in particular from an economic standpoint, merited preservation, thereby serving the goal of preservation of employment, and, in the event of liquidation, maximizing the value of the assets that were available to pay creditors' claims, without undue regard to the location of those assets.

5. It was widely reported that, in sharp contrast to the proliferation of multinational economic activity, the prevailing legal environment was generally not suitably geared to achieving the above-mentioned objectives in cases of cross-border insolvency. Many national insolvency laws claimed, for their own insolvency proceedings, application of the principle of "universality", according to which a unified administration of the insolvency would be the objective and court orders would be effective with respect to assets located abroad, while failing to accord recognition of universality to foreign insolvency proceedings. An example of difficulties that may arise in the context of a reorganization proceeding was the case in which one jurisdiction envisages a "debtor in possession" continuing to exercise management functions, while, under the law of another State in which a contemporaneous insolvency proceeding is being conducted with respect to the same debtor, existing management is displaced or the debtor's business is to be liquidated.

6. It was reported that, in such a prevailing legal environment, fragmentation and compartmentalization along national lines were prevalent in the administration of cross-border insolvencies. It was further reported that, in the face of gaps or inadequacies in the law, courts and practitioners attempting to harmonize administration of cross-border insolvencies might find that, at best, they had to attempt to rely on ad hoc protocols or agreements among the parties involved in administering the insolvency proceedings in order to provide for a harmonized administration of the insolvency estate in the cross-border context. Such procedures, which might be based on interpretations of general notions such as international comity, often would take place in an atmosphere of legal uncertainty that resulted from an inadequate legislative framework for cooperation.

7. While it was widely felt that it would not be feasible, at least in the foreseeable future, to solve those problems by way of a substantive unification of laws affecting cross-border insolvency proceedings, a variety of specific needs were identified that might be addressed by efforts short of unification of substantive law. Those specific needs included, in particular: systems to facilitate, in the context of liquidation proceedings, preservation of collateral and quick liquidation or, in the context of reorganization proceedings, mechanisms for facilitating rescue and rehabilitation of viable businesses by way of moratoria to prevent action by individual creditors; mechanisms at the legislative level to provide for the recognition of duly-appointed representatives and the recovery of assets, including by way of providing information to foreign insolvency proceedings; greater information and certainty for secured lenders as to the identity of the items in which they hold security; simplified systems for proving claims, in particular allowing creditors in appropriate circumstances to claim in their own countries and in their own language; recognition of foreign court orders; and recognition and enforceability of "net positions" of banks involved in multilateral netting arrangements.

B. Law reform efforts at the national level

8. Attention was drawn to law-reform efforts in a limited number of States that had taken place, or that were in progress, designed to foster a greater degree of universality in administration of cross-border insolvencies, as a basis for assistance other than the basis of comity or mere rules of private

international law. It was suggested that those efforts, which typically involved establishing mechanisms for granting court access to representatives of foreign insolvency proceedings and otherwise granting recognition to foreign proceedings, might serve as an indication of what might be feasible in terms of international harmonization.

9. Key features of such national law reforms intended to establish flexible frameworks for dealing with cross-border insolvencies included, for example: an opportunity for representatives of foreign insolvency proceedings to petition the bankruptcy court for ancillary proceedings, available at the discretion of the court or perhaps mandatory, to assist in the administration of the foreign insolvency proceeding; various forms of ancillary relief including injunctions blocking actions against the foreign debtor or property in the forum and turnover of property to the foreign representative for administration in the foreign proceeding; possible suspension or dismissal of a forum bankruptcy proceeding in deference to pending foreign insolvency proceedings; the opportunity for the foreign representative to petition for a full, involuntary insolvency proceeding as an alternative to a mere ancillary proceeding; appearances before forum courts by foreign representatives treated as "special appearances", thus not subjecting the foreign representative to the jurisdiction of the forum for any other purpose; criteria for assessing foreign proceedings for purposes of determining whether to recognize court exercise of discretion as to whether to grant recognition or ancillary relief (e.g., similarity on essential points between the legal system of the forum state and the foreign state; just treatment of all creditors; comity).

C. Initiatives at the international level

10. It was observed that, at the same time that specific provisions in national legislation designed to deal with cross-border insolvency remained the exception, there was also a lack of an extensive network of bilateral treaties that might provide relief, as well as a lack of a multilateral treaty arrangement on the global level. Multilateral treaties on a regional basis are, for example: in Latin America, the Montevideo Treaties of 1889 and 1940; in the Nordic region, the Convention between Denmark, Finland, Iceland, Norway and Sweden regarding Bankruptcy (concluded in 1933 and amended in 1977 and 1982); among the member States of the Council of Europe, the European Convention on Certain International Aspects of Bankruptcy (Istanbul, 1990); and, in the European Union, the draft Convention on Insolvency Proceedings.

11. Mention was also made of certain non-Governmental initiatives with a view to providing a legal framework or basis for harmonization of cross-border insolvency proceedings. One such initiative was the Model International Insolvency Co-operation Act ("MIICA"), formulated by Committee J of the Section on Business Law of IBA. The view was expressed that the experience of MIICA suggested the importance for the eventual success of harmonization efforts, in particular when those efforts took the form of model legislation, of involving Governments in the formulation process. It was noted that Committee J was currently engaged in a review and analysis of fundamental insolvency concepts with a view to developing a Model Insolvency Code, a set of uniform concepts that would be acceptable to or adaptable into domestic legislation. Another initiative to which attention was drawn was the research being conducted by the American Law Institute into a framework for cross-border insolvencies among the member countries of the North American Free Trade Agreement (NAFTA). (Additional information on multilateral initiatives towards regulation of cross-border insolvencies is presented in A/CN.9/378/Add.4.)

D. Cross-border judicial cooperation, ad hoc protocols and concordats

12. Particular attention was given in the discussion to the crucial function that is performed in cross-border insolvency by cooperation among the judges and counsel from the various States in which assets of the debtor might be found and in which insolvency proceedings are taking place. It was noted that the significance of such cooperation was enhanced, but that cooperation was made more difficult, by the absence of an adequate legislative framework for dealing with cross-border insolvencies and when there was a need to reconcile differences in the applicable national insolvency laws. Notable examples of judicial cooperation, and of cooperation among counsel and representatives of creditors and debtors, were described to the Colloquium by judges and counsel involved in a number of particularly significant cases of cross-border insolvency that have taken place in recent years. It was observed generally that an obstacle that hampered and made uncertain judicial cooperation was that judges seeking to establish cooperation typically had to do so without much guidance in the law.

13. Specific attention was also given in the discussion to the function that may be performed in a cross-border insolvency case by an ad hoc protocol agreed to by the various parties in interest and approved by the supervising judges. Such a protocol may be used, for example, to establish the system of corporate governance that will be applied to the debtor in a reorganization proceeding. A protocol dealing with corporate governance might address issues such as appointment of directors, procedural rules for boards of directors, judicial review procedures in connection with removal of directors, and recognition of certain rights of the insolvency administrator, including the right to receive information.

14. In connection with such ad hoc arrangements, the Colloquium noted with interest the work conducted by Committee J of the Section on Business Law of IBA on a "Cross-Border Insolvency Concordat". The purpose of the Concordat, the fundamental approach of which is based on rules of private international law, is to suggest rules, some of which may be applicable in any cross-border insolvency, which the participants or courts could adopt for dealing with a variety of issues. Those issues include, for example, designation of the administrative forum, application of that forum's priority rules, certain rules for cases in which there is more than one administrative forum, and designation of applicable rules for avoidance of transfers of assets that took place in the period preceding the insolvency.

CONCLUSIONS

15. It may be noted that at the Colloquium there was a high degree of receptivity to the interest expressed by the Commission in a possible project on cross-border insolvency. Taking particular note of the views and observations concerning cross-border insolvency that were aired at the Colloquium by judges, practitioners, representatives of concerned organizations and Governments, the Secretariat will continue work relating to the assessment of the feasibility of work in this area requested by the Commission. In this endeavour, the Secretariat would cooperate with interested organizations and welcomes the offer of research assistance that has been extended by INSOL International.

16. Based on a current assessment of feasibility and drawing on the discussion at the Colloquium and the consultations with practitioners and interested organizations which it facilitated, it is possible at this stage to identify a number of sub-areas of the cross-border insolvency subject in which it would appear that some work by the Commission would not only be welcome, but feasible and useful. Moreover, it would appear possible to conduct work in those sub-areas without necessarily

straying into what is generally recognized as not, at least at this stage, a feasible, or necessarily even desirable, area of work, namely, the substantive unification of insolvency law.

17. One of those sub-areas of work that may seem at first to be modest, but that drew particular attention at the Colloquium and in which it would appear feasible to make a useful contribution in a relatively short time, concerns judicial cooperation. An opportunity for pursuing work in this area has already presented itself, as INSOL International is proposing to co-sponsor with UNCITRAL and organize, in conjunction with a regional conference it is to hold in Toronto in March 1995, a colloquium for judges on judicial cooperation in cross-border insolvency. The twin objectives of the judges' colloquium would be: firstly, to elicit the views of judges as to the extent to which judicial cooperation was possible under current law, for example, by application of the notion of comity, and exploring limits to cooperation under current law; secondly, to determine what rules might be necessary to enable judicial cooperation as a first step in dealing with difficulties that arise as a result of parallel proceedings and potentially conflicting legal regimes and jurisdictions.

18. A second sub-area, which it would appear useful to pursue and which in some respects may overlap with the first sub-area, may be broadly referred to under the rubric "access and recognition". This area may be understood to concern the granting of access to the courts to representatives of foreign insolvency proceedings or creditors, and to giving recognition to orders issued by foreign courts administering insolvency proceedings. Preliminary work in this area could identify the advantages and disadvantages of the different approaches found in the existing legislative systems providing for access and recognition, as well as in legislative-reform efforts at the national and multilateral level. It could also explore, from the standpoint of the needs of practice and the objectives of insolvency (e.g., equal treatment of creditors), the appropriateness of formulating uniform rules on access and recognition.

19. A third possibility that might in due time be considered for work by the Commission is the formulation of a set of model legislative provisions on insolvency. While it was not the conclusion of the Colloquium, and it is not here proposed to draft a comprehensive insolvency code with a view to achieving substantive unification of law, work in this area of law may eventually be important not only for Governments concerned with modernization of law, but also for the commercial community and for legal practitioners. It could be foreseen that much work might be conducted in a form that would avoid the difficulties that would be raised by attempting global unification of the substantive law of insolvency. In particular, such a project could be designed in a manner that would take into account the different policy options that a State would wish to consider in drafting its insolvency law, and would present model provisions for implementing those various policy options. The Commission may wish to note in connection with this type of possible work, and with a view to possible cooperation with Committee J of the Section on Business Law of IBA, the exploratory work being conducted by that body on fundamental concepts of a model insolvency code (see para. 11).

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