United Nations A/CN.9/507

General Assembly

Distr.: General
11 January 2002

Original: English

United Nations Commission on International Trade Law
Thirty-fifth session
New York, 17-28 June 2002

Report of the Working Group on Insolvency Law on the work of its twenty-fifth session (Vienna, 3-14 December 2001)

Contents

I. Introduction

1. The Commission, at its thirty-second session (1999), had before it a proposal by Australia (A/CN.9/462/Add.1) on possible future work in the area of insolvency law. That proposal had recommended that, in view of its universal membership, its previous successful work on cross-border insolvency and its established working relations with international organizations that have expertise and interest in the law of insolvency, the Commission was an appropriate forum for the discussion of insolvency law issues. The proposal urged that the Commission consider entrusting a working group with the development of a model law on corporate insolvency to foster and encourage the adoption of effective national corporate insolvency regimes.

2. Recognition was expressed in the Commission for the importance to all countries of strong insolvency regimes. The view was expressed that the type of insolvency regime that a country adopted had become a "front-line" factor in international credit ratings. Concern was expressed, however, about the difficulties associated with work on an international level on insolvency legislation, which involved sensitive and potentially diverging socio-political choices. In view of those difficulties, the fear was expressed that the work might not be brought to a successful conclusion. It was said that a universally acceptable model law was in all likelihood not feasible and that any work needed to take a flexible approach that would leave options and policy choices open to States. While the Commission heard expressions of support for such flexibility, it was generally agreed that the Commission could not take a final decision on committing itself to establishing a working group to develop model legislation or another text without further study of the work already being undertaken by other organizations and consideration of the relevant issues.

3. To facilitate that further study, the Commission decided to convene an exploratory session of a working group to prepare a feasibility proposal for consideration by the Commission at its thirty-third session.

4. At its thirty-third session in 2000 the Commission noted the recommendation that the Working Group had made in the report of the exploratory session held in Vienna from 6 to 17 December 1999 (A/CN.9/469, para. 140) and gave the Group the mandate to prepare a comprehensive statement of key objectives and core features for a strong insolvency, debtor-creditor regime, including consideration of out-of-court restructuring, and a legislative guide containing flexible approaches to the implementation of such objectives and features, including a discussion of the alternative approaches possible and the perceived benefits and detriments of such approaches.

5. It was agreed that in carrying out its task the Working Group should be mindful of the work under way or already completed by other organizations, including the World Bank, the International Monetary Fund (IMF), the Asian Development Bank (ADB), INSOL International (INSOL) (an international federation of insolvency professionals) and Committee J of the Section on Business Law of the International Bar Association (IBA). In order to obtain the views and benefit from the expertise of those organizations, the Secretariat, in cooperation with INSOL and the IBA organized the UNCITRAL/INSOL/IBA Global Insolvency Colloquium in Vienna, from 4-6 December

2000.

6. At its thirty-fourth session in 2001, the Commission took note with satisfaction of the report of the Colloquium (A/CN.9/495) and commended the work accomplished so far, in particular the efforts of coordination with the work carried out by other international organizations in the area of insolvency law. The Commission discussed the recommendations of the Colloquium, in particular with respect to the form that the future work might take and interpretation of the mandate given to the Working Group by the Commission at its thirty-third session. The Commission confirmed that the mandate should be widely interpreted to ensure an appropriately flexible work product, which should take the form of a legislative guide. In order to avoid the legislative guide being too general or too abstract to provide the required guidance, the Commission suggested that the Working Group should bear in mind the need to be as specific as possible in developing its work. To that end, model legislative provisions, even if only addressing some of the issues to be included in the guide, should be included as far as possible.

7. The twenty-fourth session of the Working Group on Insolvency Law, which was held in New York from 23 July to 3 August 2001, commenced consideration of this work with the first draft of the legislative guide on insolvency law. The report of that meeting is contained in document A/CN.9/504.

8. The Working Group on Insolvency Law, which was composed of all States members of the Commission, held its twenty-fifth session in Vienna from 3 to 14 December 2001. The session was attended by representatives of the following States members of the Working Group: Austria, Brazil, Cameroon, Canada, China, Colombia, France, Germany, Honduras, Hungary, India, Iran (Islamic Republic of), Italy, Japan, Kenya, Mexico, Morocco, Russian Federation, Singapore, Spain, Sudan, Sweden, Thailand and United States of America.

9. The session was attended by observers from the following States: Antigua and Barbuda, Argentina, Australia, Belarus, Bulgaria, Croatia, Cuba, Denmark, Indonesia, Iraq, Lebanon, Libyan Arab Jamahiriya, Nigeria, Peru, Philippines, Poland, Portugal, Republic of Korea, Slovakia, Sri Lanka, Switzerland, Turkey and Yemen.

10. The session was also attended by observers from the following international organizations: American Bar Association (ABA), American Bar Foundation (ABF), Asian Development Bank, Center of Legal Competence (CEC), European Bank for Reconstruction and Development (EBRD), European Central Bank, Groupe de reflexion sur l'insolvabilité et sa prévention (G.R.I.P.), International Bar Association (IBA), International Federation of Insolvency Practitioners (INSOL), International Insolvency Institute (III), International Monetary Fund (IMF), Organization for Economic Co-operation and Development (OECD).

11. The Working Group elected the following officers:

Chairman: Mr. Wisit WISITSORA-AT (Thailand);

Rapporteur: Mr. Jorge PINZON SANCHEZ (Colombia).

12. The Working Group had before it the following documents: two Reports of the Secretary-General (Draft legislative guide on insolvency law, A/CN.9/WG.V/WP.57 and 58) and a note setting forth comments by the Commercial Finance Association on alternative informal insolvency processes (A/CN.9/WG.V/WP.59).

13. The Working Group adopted the following agenda:

1. Election of officers.
2. Adoption of the agenda.
3. Preparation of a legislative guide on insolvency law.
4. Other business.
5. Adoption of the report

II. Deliberations and decisions

14. At the present session, the Working Group on Insolvency Law continued its work on the preparation of a legislative guide on insolvency law, pursuant to the decisions taken by the Commission at its thirty-third (New York, 12 June-7 July 2000)[1] and thirty-fourth sessions (Vienna, 25 June-13 July 2001)[2] and of the Working Group on Insolvency Law at its twenty-fourth session. The decisions and deliberations of the Working Group with respect to that legislative guide are reflected in section III below.

15. The Secretariat was requested to prepare a revised version of the draft Guide, based on those deliberations and decisions, to be presented to the twenty-sixth session of the Working Group on Insolvency Law (New York, 13-17 May 2002) for review and further discussion.

III. Consideration of draft legislative guide on insolvency law

A. General Remarks

16. The Working Group commenced its discussion of the draft Legislative Guide with a general consideration of Part One and the Introduction to Part Two (A/CN.9/WG.V/WP.57). With respect to Part One, it was generally the view that the reference in paragraph 14 to the definition of the term “court” needed to be expanded. It was suggested that a separate section addressing the institutional framework required to support the effective and efficient implementation of an insolvency law was essential; no matter how adequate an insolvency law was, if it was rarely applied or applied badly it could never be efficient or effective. It was noted, however, that addressing the institutional

---

[1] *Official Records of the General Assembly, Fifty-fifth Session, Supplement No. 17*, A/55/17, paras. 186-192.

[2] *Official Records of the General Assembly, Fifty-sixth Session, Supplement No. 18*, A/55/18, paras. 296-308.

framework would require sensitive issues relating to the judiciary and possible judicial reform to be considered.

B. Part One. Key objectives of an effective and efficient insolvency regime

17. With respect to the Key Objectives, it was suggested that they could be used as a measuring stick to assess the recommendations to be included in Part Two and to explain to readers of the draft Guide how policy decisions on the various recommendations had been reached. Some concern was expressed however, that there was an obvious tension between the different objectives which might render them inappropriate as currently drafted for use as benchmarks. For example, it was suggested that objective 1 which focussed upon maximization of value might conflict with objective 2 which required a balance to be achieved between liquidation and reorganization and that objective 2 was really more a means for achieving objective 1 than a separate objective of an insolvency regime. To address that issue, it was suggested that the objectives be arranged in a hierarchy, and that the ways of achieving a balance between them should be discussed.

C. Part Two. Core provisions of an effective and efficient insolvency system

1. Introduction to insolvency procedures

18. In terms of the processes described in the Introduction to Part Two of the draft Guide (A/CN.9/WG.V/WP.58), general support was expressed in favour of addressing both informal (or out-of-court) processes and the so-called "hybrid" processes (with reservation being expressed as to whether that was the appropriate term by which to refer to processes which started as informal out-of-court negotiations and at some point became formal court-based proceedings). However described, it was noted that the latter processes commenced as entirely informal processes and whilst the level of agreement necessary to take the arrangement forward might not be achieved, nevertheless a significant level of support from creditors for the proposed plan may be obtained. At that point, it was often desirable to be able to take what had been achieved through informal negotiation into the formal court-based insolvency system in order to create a binding plan. It was suggested that what was required in the insolvency law was the development of a mechanism which would include the necessary protections that could be used to enable the conversion of the informal out-of-court process into formal proceedings. It was also noted that those processes had developed, in practice, to address capital structure problems rather than trade debts (which it was assumed could be managed in the course of trading) and were therefore applicable in a limited number of situations, although not only those involving international debt. It was suggested that where the particular insolvency involved significant amounts of unsecured debt, it may be inappropriate to consider using that type of process as the unsecured debt may be too large to be addressed by the group of secured creditors.

19. It was suggested that the point of time at which the process might need to be converted into formal court proceedings might differ depending upon the factual circumstances of the specific case. For example, if a moratorium was required, if there was a need for fresh capital or if management needed to be protected against possible liability for improper trading, the process might need to be converted into formal court proceedings at an early stage. If, in comparison, a formal court-based proceeding was needed to address creditors who were holding out against the proposed plan, that

conversion might come at a later stage. It was pointed out in response that, if conversion of the process could occur at an early stage, the problems of holdouts might not arise at all.

20. It was noted that informal out-of-court processes were increasingly supported in practice although the growing diversity of lender groups made them more complex and harder to achieve. It was observed that they operated in the "shadow of the law" with no binding effect and were not therefore part of the legislative framework of an insolvency law. It was observed in response that they were nevertheless important because they were developed to address certain types of debtor situations and in response to certain disadvantages, in terms of flexibility, speed and cost, of the formal court-based insolvency proceedings. In addition, since those informal out-of-court processes were part of the "hybrid" process, detailed information on those processes would serve as an introduction to the so-called "hybrid" processes which included both informal and formal elements and may also be helpful in addressing how the informal processes could be integrated with formal proceedings. As a further issue, it was observed that the draft Guide did not address any international aspects of the informal process.

21. The view was expressed that the two types of process warranted detailed treatment, perhaps in a separate chapter of the draft Guide. It was suggested that it may be useful to consider in the chapter the types of debtor and debt to which those processes might apply, how they could be commenced, how they would be supervised, what relief might be required and how they could be completed in terms of voting procedures and the treatment of minority creditors who did not agree with the proposed plan (including for example, their right to be heard, the validity of preferential treatment of certain creditors and issues of fraud). It was suggested that the draft Guide should clarify the choice the debtor would have between different options, whether informal negotiation processes or formal court procedures.

22. Another view was that the "hybrid" or expedited court proceedings could be included in the parts of the draft Guide dealing with formal reorganization as a further option based upon the same standards and requirements for approval of a formally developed reorganization plan. It was suggested that that approach could encourage expedition and foster the use of informal negotiations. It was noted that a number of different organizations were researching the development of these types of processes and that the Working Group's deliberations might benefit from the outcomes of that work.

23. With respect to administrative processes, it was emphasized that because those processes had developed in response to systemic financial breakdown and were not part of the usual insolvency regime, they should not be addressed in any greater detail or accorded any greater importance than was already included in paragraph 45. It was suggested that a note of caution should be introduced lest the draft Guide be interpreted as advocating the development of those processes for general use. In that regard, it was noted that administrative processes often raised issues of transparency, particularly with regard to the acquisition of non-performing loans, and required the development of comprehensive rules to ensure their proper operation.

24. With regard to the relationship between liquidation and reorganization it was suggested that the draft Guide should address the limits required to ensure that the process was not abused by, for example, a debtor or creditor commencing successive proceedings or, where the threshold for liquidation was too low, a creditor commencing proceedings against a debtor in an attempt to gain control of the debtor or its assets. It was also suggested that paragraph 54 should address the situation where a business could

be sold as a going concern in liquidation or where reorganization involved the sale of the debtor's assets or transfer of the business to another entity.

2. Application and commencement of insolvency proceedings

A. Scope of the insolvency law

25. The Working Group exchanged views as to which debtors should be subjected to the insolvency regime.

26. A suggestion was that the insolvency of charities and similar entities should be addressed in the draft Guide. In response, it was noted that such inclusion would be inconsistent with the terms of the mandate of the Working Group, which was limited to entities involved in commercial business activities. Accordingly, it was agreed to focus on commercial insolvency only, without prejudice however to the desirability of the draft Guide mentioning that national laws could provide for the insolvency regime to be extended to debtors other than business entities.

27. Different views were expressed as to whether individuals should be included within the scope of the insolvency law. A view was that in principle no distinction was to be made on the basis of the individual or corporate structure of the debtor, provided that countries would always be able to include provisions specifically applying to individual debtors only. Focus should rather be put upon the conduct of trade and business, irrespective of the structure of the entity by which the business activity might be conducted. It was suggested that a debt limit might be provided in respect of small business entities with a view to avoiding proliferation of small filings.

28. A different view was that only debtors of a corporate nature should be included, given the limited relevance to the economy generally of insolvency concerning individual or personal business entities. A similar view relied on the assumption that treatment of the insolvency of individuals raised a number of policy and social considerations (including the issue of discharge), which were likely to be addressed in different manners within the various legal systems. Furthermore, the treatment of individual insolvency might prove especially difficult when reorganization was at stake.

29. After discussion, the prevailing view was to avoid distinctions based on the individual or corporate structure of the debtor. The Working Group was reminded that any decision in that respect would have to be accurately reflected in the glossary appearing in the introductory part of the draft Guide.

30. It was pointed out that paragraphs (5) to (7) of the Summary and recommendations section addressed issues of international jurisdiction and competence, as such falling outside the scope of the discussion on the identification of the debtors to which the insolvency regime would apply. It was further observed that it would be inappropriate for a legislative guide to suggest restrictions or limits to national states as to the criteria for international competence in insolvency matters.

31. Some support was expressed in favour of including in the draft Guide a discussion of the issues arising in connection with consolidation of multiple debtors and related debt, as well as of the principles which should be followed in addressing those issues, with a view to ensuring that the insolvency of debtors being or acting as connected be treated in an equitable manner.

B. Application and commencement criteria

32. A suggestion was made that the reference in paragraph 17 of the Commentary to the "balance sheet" test as an alternative standard to the general cessation of payments standard for liquidation proceedings was potentially misleading. In that regard, it was noted that a clear distinction must be drawn between a test based on the "book value" of the assets and their "market value." It was noted that the market value represented a more reliable measurement of the worth of the business concern, while the book value presented a potentially inaccurate picture of the business as a consequence of variations in accounting practices.

33. The issue of application for the commencement of liquidation procedures was discussed. In the case of creditor-initiated applications, it was noted that a single incident of non-payment by the debtor should not suffice to enable a creditor to initiate liquidation procedures (*see* paras. 20-22 of the Commentary). Regarding whether creditors holding non-mature debt should be able to initiate insolvency proceedings concern was expressed that such a capability carried the potential for abuse by creditors who may threaten to commence insolvency proceedings in order to pressure debtors to negotiate preferential payments (*see* para. 20). In that regard it was noted that paragraph 23 provided that creditors with non-mature claims should perhaps be able to commence insolvency procedures in exceptional circumstances which might include to prevent incidents of abusive behaviour such as fraud by the debtor. The view was stated, furthermore, that government authorities should not utilize insolvency proceedings to the extent alternative legal means were available to counter illegal acts or acts which may be contrary to public policy.

34. Similarly, the need for flexibility to be expressed in the Summary and recommendations section was noted. The view was stated that while it was possible for the same criteria to be applied to applications for liquidation and reorganization, the criteria for reorganization should be broader, in keeping with the principle underlying the draft Guide of encouraging *bona fide* early commencement and reorganization before the debtor becomes overburdened with debt. (*see* Summary and recommendations paras. (2) and (3)). Consistent with that approach it was further noted that a flexible time in which a court must make a decision on an involuntary application was preferable, and that specifying a particular number of days for a judicial response might raise constitutional issues in certain jurisdictions (*see* Summary and recommendations para. (7)).

35. A suggestion was made to include an additional sub-paragraph in paragraph (1) of the Summary and recommendations stating that a purpose of provisions in insolvency law on application and commencement criteria was to ensure the adoption of criteria that were transparent and certain.

Costs

36. General support was expressed in favour of the issue of costs being addressed in the draft Guide, with a view to preserving the crucial objective of the overall cost-effectiveness of the procedure. More specifically, it was observed that it was important to avoid a situation where the procedure was subject to cost burdens that might work as a deterrent to creditors and therefore frustrate objectives of the procedure.

37. It was pointed out that clarification was desirable as to the identification of the items which were to be understood under the term "costs". In that connection, it was suggested that application fees should be addressed separately from fees pertaining to professionals involved in the administration of the estate, or other expenses arising with

respect to the procedure and that criteria as to their respective ranking within the procedure should be established.

3. Consequences of commencement of insolvency proceedings

A. The insolvency estate

38. General support was expressed in favour of the position that the insolvency estate should include all assets which the debtor owned or in which the debtor had an interest, including those in which secured creditors had rights, at the time of the commencement of the proceeding, as reflected in paragraph 43. However, it was suggested that the draft Guide should clarify that the existence of such ownership or interest should be assessed in accordance with the applicable property law, rather than being established in an insolvency law. An alternative view was that such a determination in accordance with applicable property law could frustrate the establishment of an effective insolvency system and accordingly, that approach should not be followed.

39. In respect of assets acquired after the date of commencement, a concern was that the wording of paragraph 42 might be too restrictive, in that it limited such assets to those acquired "in the exercise of avoidance powers or in the normal course of operating the debtor's business". Accordingly, it was suggested that the paragraph be redrafted to clarify that any assets acquired by the debtor would fall within the scope of the insolvency estate irrespective of the way in which such acquisition occurred.

40. Support was expressed in favour of addressing the treatment of specific contractual arrangements, such as transfers created for the purpose of security, trusts and fiduciary arrangements or consigned goods. As a general remark, it was suggested that the close link existing between the issue of the extension of the insolvency estate, on the one hand, and the treatment of specific claims, on the other, particularly in connection with the scope of the stay to be applied to actions brought by individual creditors be addressed.

41. Reference to assets to be "readily found on the balance sheets" appearing in paragraph 43 was found to be misleading as those assets were often not found on the balance sheets and its deletion was suggested.

42. In respect of reorganization, the Working Group agreed that the draft Guide should clearly spell out the need to include in the estate all the assets which were crucial for reorganization to be successful. In that connection, it was also suggested that an explicit link might be established between the scope of the estate and the purpose of the proceeding (i.e. reorganization as opposed to liquidation). A further suggestion was that the draft Guide should make a distinction between property or other rights (including security interests) in the assets, which would not be affected by commencement, and the exercise of those rights, which might be limited for the purposes of carrying out the reorganization procedure.

43. As to paragraph 52, it was observed that the ability to sell the assets had to be addressed separately from the issue of the methods or procedures by which such sale had to occur.

B. Protecting the insolvency estate

44. The Working Group discussed the issue of the stay and its application in insolvency proceedings. The importance of the stay was noted to preserve the status quo and allow time for a decision to be made regarding reorganisation or liquidation as early as possible. The view was stated that the draft Guide should emphasize the importance of an adequate judicial infrastructure in order to facilitate the stay.

45. As a general remark it was observed that paragraphs 62 and 63 of the Commentary addressed the types of actions to which the stay applied while the Summary and recommendations section focussed upon the parties to which it would apply. It was suggested that the Summary and recommendations should address both issues.

Paragraph (1) – purpose clause

46. A number of suggestions were made with regard to the drafting of the purpose clause. It was suggested that the meaning of the phrase "various parties in interest" in subparagraph (a) should be clarified. It was also suggested that the meaning of the phrase "activities to be affected by" in subparagraph (b) was uncertain and should be deleted in order to broaden the application of the text. It was further suggested that subparagraphs (b) and (c) could be merged and that the grounds for relief from a stay could be set forth in subparagraph (d).

Variants 1 and 2 – discretionary and automatic application of the stay

47. The draft Summary and recommendations set forth two variants; variant 1 providing for a discretionary application of the stay, and variant 2 providing for an automatic application of the stay. It was suggested that variant 1 should be deleted and that automatic application of the stay be recommended. In that regard it was observed that the discretionary application of the stay by a court discussed in variant 1 was potentially complex and lengthy, with the potential for dismemberment of the assets of the debtor during the time the stay was being considered by the court, whereas the automatic stay enhanced certainty and was more predictable. The importance of an automatic stay in the case of insolvencies involving global tort claims was emphasized.

48. It was noted that while the stay should apply automatically on the commencement of the insolvency proceedings, it would not interfere with the court's discretion to decide whether proceedings should in fact commence. In addition, it was suggested that provisional measures (which might include a stay) which might apply between the time of the application for commencement and actual commencement would only be available at the discretion of the court. In that regard, it was suggested that the structure of articles 19-21 of the UNCITRAL Model Law on Cross-Border Insolvency could be adopted. Under that approach the stay could be applied on a provisional basis between application and commencement; it would apply automatically on commencement to specified actions, with the possibility of additional measures being ordered at the discretion of the court. That proposal was supported.

49. Although the stay would be generally applicable by reference to the commencement of the proceedings, it was proposed that the language of the draft Guide needed to be more specific. It was noted that in some jurisdictions, the stay became effective as of the time of the court's decision to commence proceedings, in others when the decision as to commencement became publicly available, while in yet other jurisdictions the stay became effective retroactively from the first hour of the day of the order. It was noted that the rules on the time at which the stay applied would be important to protection of the estate and in terms of the application of the stay to payments and the need to minimise systemic risk.

Paragraph (3) – provisional measures

50. The Working Group agreed that provisional measures should be available to address the period between the application for commencement of proceedings and commencement and it was suggested that the draft Guide might further discuss the reasons why such discretionary provisional measures might be necessary. As to the scope of provisional measures available, it was suggested that they should be limited to execution actions.

Scope of the stay

51. As to the scope of the stay, various suggestions were expressed as to what might be covered and to whom it should apply. It was noted that as drafted, the recommendations provided that the stay would apply to both secured creditors and unsecured creditors, but not to third parties. It was observed that actions against the estate by parties who were not creditors, such as personal injury claimants, might need to be considered, as well as directors (particularly where they had provided guarantees in respect of the indebtedness of the debtor) and, in the case of reorganization, managers (at least until the reorganization plan was approved). It was noted that that approach would require a distinction to be drawn between the application of the stay in liquidation and reorganization. As to the types of actions that should be covered, it was suggested that the language of article 20 of the UNCITRAL Model Law on Cross-Border Insolvency might indicate an appropriate approach.

Paragraphs (5) and (6) – duration of the application of the stay to secured creditors and relief from the stay in liquidation

52. The view was stated that paragraph (5) should provide as a default rule the application of the stay to secured creditors for a short period, after which they could attempt to enforce against their security unless the insolvency representative requested the court to extend the stay. Some support was expressed in favour of that approach. Another view was that a distinction could perhaps be drawn between liquidation and reorganization, with the stay applying for a short period only in liquidation. It was noted that it was often the case that secured creditors were over-secured, and while they would generally seek to take every opportunity to enforce their security and remove themselves from the insolvency situation, there was no reason why the stay would not continue to apply to them for the duration of the proceedings. In light of the administrative burden placed upon the insolvency representative, it was suggested that a default rule which required the insolvency representative to take action to extend the stay might constitute an unnecessary additional burden and encourage litigation. It was observed that paragraph (5) as currently drafted had the advantage of flexibility in that it left to the court the decision to provide a remedy if there was prejudice to the secured creditor or creditors.

53. The provision of relief from the application of the stay for secured creditors as set forth in paragraph (6) was discussed. As an initial matter it was noted that providing an exception for secured creditors risked facilitating the dismemberment of the insolvency estate thus frustrating the goal of the insolvency proceedings and the stay which was designed to ensure the protection of the estate. As such, it was suggested that allowing a secured creditor to realize its security might constitute a preference that could not be justified. It was also noted that since certain jurisdictions granted the same level of priority to employment-related claims as to secured creditors, those employee claims might also be granted relief from the stay. In that regard, it was noted that some jurisdictions provided certain classes of claims with a "super-priority" for a specified period, including claims for wages due and that in others employee contracts received

special treatment under labour-related laws. The view was expressed that the exception in paragraph (6) should not be allowed to result in some additional priority being given to secured creditors at the expense of other creditors. If relief from the stay was to be granted, the draft Guide should clearly set out the applicable grounds, whether lack of adequate protection, reduction of the value of the security or others.

54. The view was stated that the protection potentially available to secured creditors through paragraph (6) was generally acceptable. It was noted that as currently drafted, each of the criterion listed in paragraph (6) had to be met in order for the secured creditor to gain relief. In comparison, paragraph (10) was seemingly satisfied if a single element was met. It was suggested that if in the light of the discussion in the Working Group, these two paragraphs were still required, further consideration of the language might be needed.

Paragraph (9) – application of the stay in reorganization

55. It was observed that paragraph (9) addressed the principle of the equality of secured and unsecured creditors. The view was expressed that since secured creditors could apply for relief from the application of the stay after a period of time, while unsecured creditors did not have such an option, paragraph (9) might need to be revised to reflect the actual position of the parties.

Paragraph (10) – lifting of the stay applicable to secured creditors

56. It was suggested that if a reorganization was to be a decisive means of reconciling all claims, including those of secured creditors, the stay against secured creditors should apply until approval of the plan as a means of achieving a balance between secured creditors and collective interests. Allowing secured creditors to lift the stay prior to that time could jeopardise reorganisation and result in prejudice to other creditors. There was general agreement that relief from the stay for secured creditors was warranted where there was no realistic possibility of reorganization and the proceedings might be converted to liquidation. A question was raised as to what occurred where the proceedings were converted to liquidation in terms of the stay. It was pointed out that if the rules on application were the same for both proceedings, no issue arose but where they were different the insolvency law would need to address the question of which rules would apply.

57. It was observed that while paragraph (5) proposed application of the stay for a limited period, that consideration was not reflected in the drafting of paragraph (10) which did not establish a limit for the duration of the stay. The related issue of potential abuse by debtors who filed repeated applications for reorganization (in circumstances where there was no prospect of a reorganization plan being approved) to keep secured creditors at bay was noted and the inclusion of safeguard provisions suggested. The view was also expressed that the issue of abusive tactics perhaps could be better addressed in the portion of the draft Guide dealing with reorganisation plans. It was also noted that paragraph (10) did not address the issue of "adequate protection" for the secured creditor, although that was raised in paragraph (11). It was suggested that the concept of "adequate protection" might need be expanded and should refer, amongst other things, to the possibility that in addition to fixing the value of the secured assets as of a specific date, the secured creditor should be able to obtain replacement liens or other types of protection.

C. Treatment of contracts

58. The Working Group exchanged views as to the treatment of contracts which had not been fully performed by either party upon commencement of the insolvency proceedings.

59. As to the overall structure of the chapter and the relevant recommendations, it was suggested that the issues of continuation and termination, on the one hand, and that of assignment, on the other hand, should be separately addressed. Some concern was expressed as to what was to be covered by the reference to "contracts" and it was suggested that some explanation be set forth in the draft Guide. It was also suggested that a reference to "contracts" was perhaps inappropriate and should instead be to the obligations continued or terminated.

60. Support was expressed in favour of mentioning in the recommendations the criteria upon which the insolvency representative should decide whether to continue or terminate a contract, it being understood that the exercise of those powers was exceptional and that any criteria for their exercise must relate to the goals of maximising the assets for the benefit of creditors. In response, it was observed that including those criteria in the text of the legislative recommendations might give rise to uncertainty and that, accordingly, they should rather be set forth in the Commentary section of the draft Guide.

Paragraph (1) – purpose clause

61. The use of the term "interfere" in paragraph (1)(a) to designate the power of the insolvency representative to either terminate or continue contracts was felt to be inappropriate, since it might suggest a power to vary the contents of the contracts. Accordingly, it was suggested that the paragraph simply refer to "the power to terminate or continue" or be drafted without referring to the party which might have the ability to exercise those powers.

62. A further concern was expressed in respect of limiting the exercise of the power to either terminate or continue contracts to the insolvency representative. It was pointed out that such a limitation might be too restrictive for those legal systems where an insolvency representative was not appointed and the insolvency estate remained in possession of the debtor. Some support was expressed in favour of addressing that situation in the Commentary section of the draft Guide. An alternative suggestion, that the definition of "insolvency representative" contained in the glossary be amended so as to encompass the debtor in possession, was objected to on the basis that the general definitions should avoid mentioning devices or mechanisms which were peculiar to only some legal systems and that the concept of the insolvency representative as used throughout the draft Guide seemed to suggest the need for both qualifications and relevant competency.

63. After discussion, the Working Group reaffirmed as a general view that the draft Guide should focus on the insolvency proceeding being conducted by an entity appointed by or operating under the control of the court.

Paragraphs (2) and (3) – termination of contracts

64. With respect to paragraph (2) of the Summary and recommendations which provided for termination of contracts, it was noted that in practice no decision was often taken in respect of outstanding contracts because they simply could not be performed and that requiring an explicit choice to be made for any single contract would result in an

excessively costly and cumbersome procedure. It was suggested that that point should be reflected in the draft Guide as an underlying premise of the chapter.

65. Another view was that a specific time-limit should be provided within which the insolvency representative was required to make its decision to either continue or terminate a contract, with a view to providing certainty. That time-limit should be reasonably short (a 45-60 day deadline was proposed) and be combined with a default provision to the effect that all contracts for which no decision had been taken within the deadline would be deemed to be terminated.

66. While that proposal was widely supported, it was pointed out that automatic termination by operation of a default provision should only apply to contracts which were not only outstanding at the time of commencement, but also known to the insolvency representative. No automatic effect would be acceptable when the insolvency representative was not aware of a contract and therefore not in a position to make a choice. Furthermore, the consequences of failure to take a decision within the prescribed time-limit (i.e., whether termination or continuation), were likely to involve both cost and issues of professional liability if the termination or continuation were found to be contrary to the interests of the insolvency estate.

67. Another view was that the issue of automatic termination should be treated differently depending on whether liquidation or reorganization was at stake. While, in principle, automatic termination would be acceptable in a liquidation procedure, more flexibility was needed in respect of reorganization, with a view to avoiding the situation where the failure to take a timely decision deprived the estate of a contract which might be crucial for the procedure. The suggestion that the insolvency representative be allowed to seek an extension of the deadline for those contracts which were deemed to be possibly useful for the estate, however, was objected to on the basis that it could exacerbate the administrative burden already borne by the insolvency representative and would conflict with the need for flexibility.

Paragraph (4) – effect of termination

68. It was further suggested that the issue of control of the decisions of the insolvency representative should be addressed in a broad provision dealing with the consequences of those decisions, including damages, as currently mentioned in paragraph (4). In that connection, the prevailing view was that damages possibly arising in connection with termination of contracts should be subject to the general rules on damages, also the determination of quantum. Those rules should apply without prejudice to the effectiveness of indemnification clauses being subject to the control of court. The proposal that those damages be treated as debts of the insolvency estate and given priority was not supported on the grounds that many claims in insolvency arose from breached contracts and an approach which accorded them priority would give to those claims an excessive advantage not supported by general policy considerations. It was also noted that in some cases there may be justification for limiting the claims arising from termination, such as in a long-term lease where the outstanding period of the lease could lead to large claims, and the lessee in any event had an opportunity to mitigate its potential losses. A similar situation might arise in respect of employment contracts where the employee often had an opportunity to seek alternative employment.

Paragraphs (5) and (6) – continuation of contracts

69. General support was expressed in favour of set-off being allowed in respect of contracts other than financial contracts. As a general remark, it was suggested that the systemic implications of financial contracts required their exclusion from the scope of

the power of the insolvency representative to continue or terminate contracts and that the reasons supporting that exclusion should be mentioned in the draft Guide. It was further suggested that loan accommodations should also be expressly mentioned as deserving special treatment.

70. Concern was expressed that employment contracts should be treated in the insolvency law differently to other contracts, although it was noted that they may be subject to other laws which might, for example, accord them a high priority in terms of claims. It was also suggested that the question of whether the treatment of employment and similar contracts in an insolvency context should be dealt with by the insolvency court or some other other specialized administrative or judicial bodies should be left to national laws and not addressed in the draft Guide. The Working Group reaffirmed that the issue of termination of certain classes of contracts involving weak parties, such as employment contracts, should be left to the discretion of national legislators and accordingly the drafting of paragraph (5) amended from "should" to "may". It was suggested that the draft Guide might suggest to national legislators that a device for protection of those parties, possibly including social security systems and the like, should be considered.

Paragraph (7) – termination clauses

71. Several views were expressed in respect of the treatment of clauses providing that the commencement of insolvency proceedings constituted an event which could lead to termination of the contract. While recognizing the desirability of the draft Guide mentioning possible different levels of invalidity, as currently provided in paragraph (7), it was pointed out that it was for the law and not for the insolvency representative to establish that such a clause was either null and void or ineffective. Accordingly, the insolvency law might provide for those clauses to be either ineffective vis-à-vis the insolvency representative or void *tout court*. As a matter of drafting, it was further suggested that the opening words of paragraph (7) be amended to clarify that termination under such a clause was the effect of the commencement of the proceedings rather than of the clause as such.

Paragraph (8) – effect of continuation

72. Some support was expressed for the view that paragraph (8), referring to the regime of claims arising from contracts continued by the insolvency representative, should be interpreted to mean that claims arising in that connection should be treated as a debt of the estate and given priority as expenses of administration of the estate. A contrary view was that according such claims a priority could not be justified. It was also pointed out that the issue was linked to the one of post-commencement financing and might therefore also be addressed in that context.

Paragraphs (9) and (10) – assignment

73. In respect of assignment, support was expressed in the Working Group for retaining the provision providing for the assignment of the contract by the insolvency representative upon approval of the court, irrespective of the existence of an assignment clause and of the agreement of the parties. Some concern was expressed however that the matter should be governed by the general law of contract, rather than be subject to special rules in an insolvency law. Under that approach if the parties to the contract agreed to the assignment it could occur and if not, no assignment could be made. It was suggested that if the provision were to be retained as an exception to general contract law, some qualifications as to the circumstances in which such an assignment could take place might need to be be added. Support was also expressed for enabling the insolvency

representative to override non-assignment clauses whenever those clauses were allowed under the general law of contracts. In that connection, it was pointed out that the term "non-assignment clauses" should include clauses with the effect of restricting assignment as well as prohibiting it.

Paragraph (11) – exercise of insolvency representative's powers

74. It was recommended that the rules stated in paragraphs (9), (10) and (11), providing for the power of the insolvency representative to decide upon termination, continuation and assignment of contracts without approval by the court, should be subject to the right of interested parties to seek judicial review of decisions taken by the insolvency representative and should be realigned in the light of the discussions on other paragraphs of the Summary and recommendations section.

D. Avoidance actions

75. Following some suggestions as to the appropriate terms to be used in the context of avoidance actions in different languages, the Working Group agreed to focus on the substantive regime and to defer terminology issues to a later stage.

76. As a preliminary remark, it was pointed out that the draft Guide should clarify that avoidance actions were specifically aimed at preserving the integrity of the estate and the fair treatment of creditors within the context of insolvency, without purporting to replace or otherwise affect other devices for the protection of the interests of creditors that would be available under general civil or commercial law.

Paragraph (1) – purpose clause

77. In that connection, a concern was that reference to the fraudulent nature of the act, appearing in paragraph (1)(a) of the Summary and recommendations section as a ground for avoidance as an alternative to the act being in violation of the equal treatment of creditors, might be misleading and that both references should therefore be deleted. In response, it was observed that mention of fraudulent acts could be usefully retained as a specific example of an act prejudicial to the creditors as a whole, provided that either the Commentary or the Summary and recommendations section, or both, clarified that avoidance actions brought against fraudulent acts were aimed at allowing the reintegration of the estate.

78. As a matter of drafting, it was suggested that the provision might be usefully simplified by replacing the phrase "the circumstances in which certain transactions which occurred prior to insolvency proceedings" by the phrase "the circumstances in which transactions prior to insolvency proceedings".

79. The suggestion that paragraph (1)(c), mentioning recovery of money or assets from third parties as one of the purposes of avoidance actions, be deleted was objected to on the grounds that the provision might usefully serve a pedagogic function.

80. As to the relationship between Variant 1 and Variant 2, it was noted that each one addressed different issues arising in the context of avoidance actions and were therefore both proposed for discussion by the Working Group.

Paragraph (2) – transactions capable of avoidance – Variants 1 and 2

81. Satisfaction was expressed with the degree of detail provided in Variant 1 in respect of the types of acts to be addressed, the circumstances triggering the possibility of avoidance and the duration of the suspect period respectively applying to them. A

suggestion was that the paragraph might reflect also the core elements of the main categories of avoidable transactions (i.e., fraudulent, undervalued and preferential transactions), as respectively set forth in paragraphs 134, 135 and 136 of the Commentary.

82. Various views were expressed as to the determination of the period prior to commencement during which transactions would be subject to avoidance (the "suspect period"). One view was that it would not be feasible to identify a single, specific period which would adequately address the cases which might occur in practice and that a flexible approach would be preferable. In response, it was observed that a fixed period was needed for the purposes of legal certainty. Whilst avoiding the suggestion of a specific period, there was support for the view that the period had to be conveniently short and that clarification should be provided as to the moment at which it started to run.

83. The Working Group agreed that a distinction had to be drawn between the issue of determination of the suspect period, on the one hand, and the limitation applying to the right of the insolvency representative to bring an avoidance action, on the other hand.

84. Strong support was expressed for avoidance of transactions involving "related persons" and "insider creditors" being specifically addressed. Whilst clarification as to the persons respectively included in those categories was recommended, possibly by supplementing the glossary and bearing in mind that entities other than individuals might also qualify as "related persons", it was suggested that those transactions be addressed in a separate paragraph rather than listed as a distinct category of avoidable acts. Reasons therefor included the need to establish special, derogatory rules for those transactions both as to evidentiary issues and the duration of the suspect period.

Paragraph (3) – extension of suspect period

85. Opposition was voiced against the court being able to extend the duration of the suspect period, as provided in paragraph (3). It was suggested that the discretion of the court in that respect could result in an excessive degree of uncertainty being cast over business transactions as a whole and in the impairment of the overall crucial goals of legal certainty and predictability.

86. A concern was that fixed time limits might not be adequate to address the issue of prejudicial transactions concealed by the parties that were discovered after expiration of the period in which an avoidance action could be brought. In response, it was noted that (i) the limitation period of the right to bring the action would not run prior to those actions becoming known to the insolvency representative, pursuant to the general rules governing limitation, and (ii) those situations might be addressed by resorting to the remedies provided and still available under laws other than insolvency law, including remedies of a criminal nature.

Paragraph (4)and (5) – evidentiary issues

87. The Working Group agreed that the draft Guide should provide advice in respect of the treatment of evidentiary issues arising in connection with avoidance actions. It was recalled that in many legal systems presumptions covering one or more of the requirements of avoidance actions and, accordingly, reversal of the burden of proof upon the counterparty of the debtor were provided. Accordingly, it was advocated that the draft Guide clearly identify the elements to be proven and the elements to be presumed, in the latter case also specifying whether such presumption was rebuttable. Nevertheless, a note of caution was struck to the effect that the draft Guide should avoid providing excessively detailed qualifications, especially on issues of a procedural nature, as those could be left to national laws. In that connection, it was reaffirmed that the purpose of a

legislative guide, as opposed to a model law, was not to be prescriptive but rather to provide guidance to legislators by highlighting issues and setting out policy options with a view to possibly recommending one or more among them.

88. As to paragraph (5)(b), it was pointed out that requiring the counterparty to an allegedly fraudulent transaction to establish the debtor's innocent motive would be tantamount to preventing that party from being successful in resisting avoidance, since it may be impossible for it to provide such evidence. Furthermore, it was noted that the solution was inconsistent with the approach taken by a number of legal systems, where good faith was presumed and only evidence of bad faith might be required.

Paragraph (6) – failure to pursue avoidance actions

89. Support was expressed for including in the draft Guide a discussion dealing with the failure of the insolvency representative to file avoidance actions. While agreeing that, in principle, creditors should be allowed to exercise those actions, the Working Group recommended that the draft Guide clarify, whether in the Commentary or in the Summary and recommendations section, that such power was to be exercised to the exclusive benefit of the insolvency estate and of creditors as a whole. Furthermore, the draft Guide should establish whether creditors would be entitled to recover from the estate any costs borne in connection with the avoidance action brought in the interest of the latter and whether, if in the affirmative, that claim would be given priority. With a view to avoiding frivolous actions by creditors resulting in the disruption of the estate, a prior approval by the court could also be provided.

90. A different view was that failure by the insolvency representative to bring avoidance actions should rather entail criminal or administrative sanctions against the insolvency representative, including the appointment of a substitute representative. In response, it was clarified that a distinction was to be drawn depending upon the circumstances of the case. Failure to act due to negligence or bad faith (or, more generally, not supported by adequate justification) needed to be addressed otherwise than failure due to the insolvency representative estimating that the avoidance action was not likely to succeed and would rather result in costs being imposed on the estate. Accordingly, the draft Guide should clarify that it was for the court to assess the reasons for failure to act by the insolvency representative. Furthermore, it was suggested that the draft Guide address the issue of the exercise of avoidance actions in those systems where no insolvency representative or other administrative authority was provided.

Paragraph (7) – transactions after commencement

91. Support was expressed for the view that transactions occurring after the commencement of proceedings, currently covered by paragraph (7), did not fall within the scope of avoidance actions. While post-commencement transactions might be considered ineffective or void, depending on the legal system in question, avoidance actions were generally conceived as a device allowing acts performed prior to commencement that were prejudicial to creditors but that would be valid outside the insolvency context to be rendered ineffective. Accordingly, transactions carried out after commencement should be addressed in a different section of the draft Guide and possibly be subjected to a different treatment depending on whether liquidation or reorganization was at stake. Suggestions in that respect included dealing with that issue within the context of the administration of the estate, the application of the stay or the powers of the insolvency representative.

92. As to substance, a view was that the provision should be more specific as to the various regimes that might apply to post-commencement transactions. Establishing

voidability as a general rule was felt to be inappropriate, given that a wide range of solutions were adopted in different legal systems, including those transactions being subject to control and possible approval by the court, or their being valid but entailing the substitution of the insolvency representative. Accordingly, support was expressed for the provision to be redrafted to the effect that distinctions as to the type of act and the context (i.e., liquidation or reorganization) in which it was carried out be included. In that connection, a system of authorizations by the court and a more favourable treatment for transactions carried out in the ordinary course of business were suggested.

4. Administration of proceedings

A. Debtor's rights and obligations[3]

General remarks

93. It was observed that a section on the debtor's duties was important to the draft Guide, since the proper carrying out of those duties (particularly the duty to cooperate with the insolvency representative and the other authorities supervising the process) was often crucial for the success of both liquidation and reorganization proceedings.

94. It was suggested that the ancillary obligations implied by the debtor's duty of cooperation should be specifically identified and addressed for the purposes of transparency and predictability. Those might include the obligation (either of the individual debtor or of managers and directors of an insolvent company) not to leave their habitual place of residence, to disclose correspondance to either the insolvency representative or the court and other limitations touching upon personal freedom. It was observed that those limitations and their extension to company directors and officers were crucial to avoid disruption of the procedure by the common practice of individual debtors leaving the place of business and of directors and managers resigning from office upon commencement. A note of caution, however, was sounded as to the need to ensure that those ancillary duties were proportionate to their underlying purpose and to the overall purpose of the general duty to cooperate.

95. General support was expressed for the suggestion that the section be supplemented by setting forth the remedies that would apply upon failure by the debtor to comply with its duties.

Paragraph (1) – purpose clause

96. A suggestion was that paragraph (1) should be drafted along the lines of "(a) to ensure that full and proper information regarding the debtor, its assets and financial affairs is provided to the insolvency representative in a timely manner; (b) to identify the person or persons having the responsibility to provide such information".

Paragraph (2) – right to be heard

97. The Working Group agreed to the need to preserve the right of the debtor to be heard during the procedure and that that right should be distinguished from any right to particpate in the proceedings. Some suggestions providing that the scope of the right to be heard be restricted to "matters affecting the interests of the debtor", pursuant to the approach taken in some legal systems, or be otherwise determined on the basis of

---

[3] Reference document A/CN.9/WG.V/WP.58, paras. 152-170 and Summary and recommendations following.

whether liquidation or reorganization was at stake, did not receive support. It was observed that the right to be heard was established in the interest, and for the protection, of the debtor and touched upon fundamental issues of constitutional rights, which were not affected by the nature or purpose of the specific procedure involved.

98. A view was expressed that reference to the need to prevent the right to be heard from being abused by the debtor was not necessary, since abuse was prohibited as a general principle of law. However, a different view was that a specific mention in that context might be useful as a possible deterrent to attempts by the debtor to abuse that right with a view to obstructing the expeditious and effective conduct of the proceedings.

99. It was suggested that the right of the debtor to participate in the decision-making process would have a wider scope in reorganization than in liquidation and that the reference appearing in square brackets should be appropriately supplemented.

100. Concern was expressed in response to the suggestion that the debtor be given the right to be informed on matters pertaining to the proceedings, whether by the insolvency representative or by the court. On the one hand, it was felt that that right would impose an excessive burden upon the administration of the insolvency. On the other hand, it was observed that nothing in the law should prevent the debtor from requesting information from the insolvency representative or the court.

Paragraph (3) – debtor's obligations

101. Support was expressed for including in the draft Guide a recommendation to the effect that the obligations of the debtor be expressly identified in the law, possibly by clarifying both their contents and the persons to whom the benefit of those obligations was to accrue. A related suggestion was that a qualification might be included in respect of those systems where no insolvency representative was appointed. It was suggested that the duty of the debtor to respond to requests for information by the insolvency representative or the court might be clearly set forth as a specific aspect of the general duty to inform, with a view to enhancing its effectiveness.

102. As a matter of drafting, it was suggested that the provision might be more effective if reformulated and expressed directly (i.e., "the debtor shall co-operate …"). It was also suggested that the reference to the obligation of the debtor to provide "current" information on its affairs might be read as limiting that duty to the time of commencement, whereas relevant information covering periods prior to commencement, had also to be provided. Accordingly, "past" information should also be required, and a qualification to the effect that information had to be not only accurate and reliable, but also "complete" added to the paragraph.

103. Several views were expressed to the effect that the obligation to provide information to the court and the other insolvency bodies be extended to any person or entity which might be in a position to provide information, including banks, financial institutions and the directors or officers of related companies. The issue of the boundaries of the power of the insolvency representative to request information from third parties was however felt to be a sensitive one, since it might conflict with confidentiality or similar duties to which those parties were equally subject. As a general remark, it was observed that the draft Guide needed to clarify whether the power of requesting information from third parties, when provided, was as wide as the one vested in the insolvency representative *vis-à-vis* the debtor. It was further pointed out that such extension might be considered as a specific aspect of the general issue of the regime affecting third parties in the context of insolvency and that a section addressing those issues should be included in the chapter on the administration of the procedure. Finally, it

was recalled that the issue of the rights of third parties was addressed in the draft Guide to Enactment of the UNCITRAL Model Law on Cross-Border Insolvency. After discussion, the Working Group agreed that the topic be further discussed at a later stage.

104. The need for insolvency law to provide remedies for failure either of the debtor or a third party to comply with their obligations, with a view to ensuring the effectiveness of those obligations, was reaffirmed. Differing views were expressed as to whether the draft Guide should address that need by recommending that those remedies be provided, or by suggesting specific types of remedies (including criminal sanctions, disqualification from professional or trade associations or, in respect of individual debtors, exclusion from the benefit of discharge).

Paragraph (4) – information to be provided

105. It was suggested that paragraph (4) should appear as sub-paragraph (c) of paragraph (3), since it clarified the ways in which the objective underlying the debtor's duties to co-operate and inform might be achieved.

106. As to substance, several views were expressed as to the type of information to be submitted by the debtor. A view was that the obligation to surrender financial statements, accounts and books should be explicicitly mentioned as a crucial aspect of the duty to provide information. Furthermore, disclosure of all transactions had to be provided, irrespective of whether they were capable of avoidance or not, since it was not for the debtor to decide upon issues of avoidance. After discussion, support was expressed for the proposal that mention of some of the documents to be provided be supplemented by a general provision stating the debtor's obligation to submit any and all information that the insolvency representative might reasonably require.

107. While agreeing that timely submission of any relevant information had to be ensured, it was pointed out that the duty to provide information should be effective throughout the procedure and, accordingly, reference to commencement in the last line of the paragraph should be deleted.

108. Some support was also expressed for the proposal that an obligation to disclose any outstanding relationship to insiders and related entities be provided, without prejudice, however, to the need to take account of issues of confidentiality which might arise.

Paragraph (5) – sanctions

109. Support was expressed for adequate measures for obtaining the relevant information being provided in the draft Guide, not only in respect of possible failure by the debtor to comply with its duty, but rather as a broad principle with a general scope. In that connection, the word "alternative" might lend itself to misunderstanding and, therefore, should be deleted.

110. According to one view, the power of the insolvency representative to require and obtain information from parties other than the debtor might be appropriately addressed in the context of the section on the debtor. A different view was that the issue related to the section on the rights and duties of the insolvency representative. The Working Group reaffirmed the need for the draft Guide to specifically deal with the position of third parties.

Paragraph (6) – confidentiality

111. While agreeing on the need to ensure confidentiality, given the commercially sensitive nature of most of the information relevant to insolvency proceedings, it was

pointed out that the draft Guide might recommend to legislators the need to coordinate the insolvency and the procedural laws in that respect.

Paragraph (7) – management of the debtor – liquidation

112. Generally, it was felt that the provision should focus on the position of the debtor rather than of the insolvency representative, consistently with the subject matter of the section and address the role of the debtor in both types of proceeding. In liquidation, for example, the debtor should transfer assets to the insolvency representative (depending upon whether that occurred automatically on commencement or required some physical surrender by the debtor) and assist the insolvency representative in the disposal of assets.

Paragraphs (8) and (9) – management of the debtor – reorganization

113. Support was expressed for paragraph (8) to be amended to align it with the discussion contained in paragraphs 154-160 of the Commentary, with a view to reflecting the different options as to management in the context of reorganization. The same suggestion, it was noted, could be extended to paragraph (9).

114. Several concerns were expressed in respect of the "sharing arrangement" mentioned in both paragraphs on the basis that it might suggest a private agreement. It was pointed out that in most legal systems rights and duties respectively pertaining to the debtor and the insolvency representative were not a matter for the parties to agree upon but were rather provided and governed by the law. It was noted that the prohibition on the sale of assets by the debtor, as provided in paragraph (8), did not accurately reflect the power of the debtor to take any action as might be required in the ordinary course of business. A further suggestion was that the two paragraphs could be merged into one.

115. It was suggested that the draft Guide should address the issue of liability of the debtor, directors and managers, including material along the lines of paragraph 170, and clarify whether the estate would be liable for any damages caused by the actions of those persons and bodies. More specifically, the draft Guide should reflect the fact that different liability regimes would apply depending upon whether fraudulent or negligent conduct was implicated. It was suggested that a specific recommendation on the issue of liability might be included, irrespective of the fact that in many legal systems liability matters might be and often were governed by laws other than insolvency law. Another view was that the issue of liability should rather be addressed within the context of the duties of the insolvency representative.

116. As to the duty to adequately remunerate professionals or companies having carried out work in the interest of the insolvency estate, it was agreed that the principle should rather be addressed in the context of the duties of the insolvency representative.

B. Insolvency representative's rights and obligations[4]

117. At the outset of the discussion it was noted that the definition of "insolvency representative" in the Glossary in Part One of the draft Guide referred to the possibility that the insolvency representative might be an "entity". The question was raised of how the obligations contained in the Summary and recommendations section would apply in that case. In response it was observed that current practice in some countries included the appointment of both individuals and entities; where it was an entity that was appointed it was generally on the basis that the individuals who would undertake the work for the

[4] Reference document A/CN.9/WG.V/WP.58, paras. 171-186 and Summary and recommendations following

entity were qualified and the entity itself was subject to regulation. It was also noted that in cases where the insolvency representative was an officer of a government authority, the draft Guide might need to reflect the manner in which that appointment might affect issues such as liability, remuneration and appointment qualifications. A further consideration was that in all respects the key objective of transparency should be reflected in the procedures for appointment of the insolvency representative and its conduct of the proceedings, although it was suggested that it was of relevance to the insolvency process more broadly, including all participants in the process.

Paragraph (1) – purpose clause

118. A drafting suggestion was that subparagraph (a) should refer to the "insolvency representative" rather than to a "person" and that a reference to "qualifications" should be included in addition to "functions".

Paragraph (2) – appointment of the insolvency representative

119. With regard to the method for appointment of the insolvency representative, it was suggested that there were additional examples which could be included in the draft Guide, such as appointment by the debtor (or directors of the debtor), in some cases without authorization by the court, but with safeguards similar to those discussed in paragraph (7) or appointment by a governmental authority. It was also observed that in some legal systems the insolvency representative could be a government or public official or a group of experts, which might involve appointment processes additional to those included in subparagraph (b). Some concern was expressed about the need to include in this recommendation a reference to a provisional appointment; this should perhaps be addressed in the section dealing with the stay and provisional measures. It was observed, however, that it was not simply a question of the timing of the appointment but rather the possibility of a difference in qualifications, experience and functions. Where such a provisional appointment was made it was noted that it would only be by order of the court and not by any other means. It was questioned whether there might be cases where no insolvency representative was appointed.

Paragraph (3) – qualifications

120. It was suggested that since the term "fiduciary" was known in only some legal systems it should not be used in the draft Guide and was in any event implicit in the reference to obligations. Similarly the term "fit and proper" was common in only some systems and might be confused with the notion of competence; it was noted that the term was usually concerned with good character and an absence of criminality, rather than with competence. It was observed that in some legal systems, the method of appointment would determine the necessary qualifications of the insolvency representative (e.g. where appointed by creditors, the insolvency representative might have to be a creditor). It was noted that some legal systems included a condition relating to the nationality of the insolvency representative, and the issue was raised of how that could be defined by an insolvency law.

Paragraph (5) – conflicts of interest

121. It was suggested that paragraph 180 should refer to "prior or existing relationships" and give examples of what that might include, such as existing or prior ownership of the debtor, prior business relationships with the debtor, or representation of the debtor (in the case of a professional). It was also suggested that the degree of relationship should be addressed, for example, membership of the firm which had represented the debtor, or family members which had had some connection with the debtor. A further example of a possible conflict of interest was given of one law which

prevented an insolvency representative appointed in a reorganization from being appointed or continuing to act in the event that the reorganization proceeding were converted to liquidation. It was noted that the paragraph as drafted simply required disclosure, but it was suggested that it should go further and state that an insolvency representative could not act as such where there was a conflict of interest or lack of independence. In response, a concern was expressed that except in obvious cases, it would often be difficult to determine whether there was in fact a conflict of interest or lack of independence and that provided disclosure had been made, the appointment could generally proceed. A further view was that impartiality was essential, not merely desirable and that if required, the court could be asked to make the appropriate determination. It was suggested that any insolvency representative proposed for appointment should have a duty to disclose potential conflicts.

122. Another approach to a lack of impartiality or independence might be provided by specific sanctions or in terms of the remuneration of the insolvency representative. It was noted that some laws provided that disclosure was a condition of appointment, so that if a conflict arose after appointment, sanctions could be applied.

Paragraph (5) - functions

123. It was suggested that the functions set out in paragraph 173 of the draft Guide could be included in the Summary and recommendations section, in order to provide the clarity and specificity recommended. A different view was that the list in paragraph 173 was too long and should either be cross-referenced to the Summary and recommendations or shortened by creating general categories to describe the functions enumerated and distinguishing between liquidation and reorganization. To supplement the list and ensure that it should not be interpreted as exhaustive, the words “as specified by the court” could be added at the end of the list. A further suggestion was that the list should make reference to the function of managing the debtor’s operations, and to the obligation to report to the authorities any behaviour of a criminal nature of which the insolvency representative might become aware. It was also recalled that in discussing the debtor’s rights and obligations the Working Group had considered issues related to the operation of the debtor’s business, including supervision and sale of assets, which could be addressed in paragraph (5).

Paragraph (6) – liability

124. The view was expressed that the issue of liability was particularly important in the context of insolvency proceedings and might need to be addressed more broadly to cover not only injurious behaviour during the conduct of the insolvency (which might refer to the insolvency representative, the creditors and third parties) but also responsibility for the insolvency and the responsibility of the appointing authority and third parties. In terms of the insolvency representative, it was noted that the question of liability was closely connected to attracting qualified professionals to act as insolvency representatives and to encouraging conduct of the proceedings in a timely and professional manner. Some jurisdictions adopted the approach of presuming that the insolvency representative would exercise effective business judgement and placing the burden on the creditor or other party to prove that this was not the case. It was also noted that different standards of proof might apply to different levels of behaviour such as ordinary negligence or gross negligence. It was observed that some laws distinguished between the liability of the office of insolvency representative and the personal liability of the person performing that function, with the law often providing an indemnity from the estate for actions taken in the performance of those functions. Although a sensitive issue, it was suggested that the more the draft Guide could do to achieve clarity, the more

it would promote proper practices and professional conduct. A contrary view was that it should be left to the general law which established standards and sanctions for professional misconduct; the draft Guide should simply include a general statement along the lines of paragraph (6).

125. To address issues of liability, it was noted that the draft Guide made reference to the use of bonds and indemnity insurance. It was observed that while the bond was intended to cover loss of assets of the estate, it would generally be insufficient to cover damages, for which insurance would be required. It was acknowledged that as a solution, insurance might not be widely available in a number of countries and other solutions might need to be explored.

Remuneration of the insolvency representative

126. The view was expressed that the draft Guide should address the question of the remuneration of the insolvency representative. It was observed that remuneration should be commensurate with the qualifications of the insolvency representative and the tasks it was required to perform and achieve a balance between risk and reward in order to attract qualified professionals. As to how it should be calculated, several methods were indicated – it could be fixed by reference to an approved scale of fees produced by a government agency or professional association, determined by the general body of creditors or the court or some other administrative body or tribunal in a particular case, and it could be based upon the quantum of debts or assets (which could only be assessed at the end of the procedure when they had been sold and the value determined) of the estate. The different approaches could be indicated in the draft Guide, together with a clear statement that the priority of the remuneration of the insolvency representative should be recognized and that an insolvency law should address that issue and provide a mechanism for fixing the remuneration.

127. It was noted that there were different possible sources for payment of the remuneration. Where the estate included unsecured assets, the remuneration could be paid from those; a surcharge could be levied against assets to pay for the administration or sale of those assets where that administration was beneficial to the creditors; or a surcharge could be levied on creditors on the making of an involuntary application to cover at least initial costs and performance of the basic functions. A further issue was review of remuneration and while it was noted that that issue was addressed in part in paragraphs 220 and 221, it should perhaps be addressed specifically in the insolvency representative section and also include provision for periodic review during the course of proceedings. This would allow problems to be addressed and resolved (perhaps by arbitration between the insolvency representative and creditors) as they arose. It was also noted that the question of assetless states (paragraphs 175-176) should be linked to the remuneration issue and could perhaps be expanded by including reference to the use of simplified procedures in assetless cases.

Paragraph (7) – grounds for removal and replacement

128. The view was expressed that the reasons for removal listed in paragraph (7) were too restrictive and should be expanded to reflect the needs of the procedure, such as being able to replace the insolvency representative when it was found that the proceedings required a particular or different competency that the appointed representative did not have. It was suggested that the reasons for removal should indicate clearly the standard of care to be observed whether by reference to professional qualifications or some other factor and that the reasons enumerated might need to be extended to include illegal acts, acting in a situation where there was a conflict of interest and other acts that would justify removal.

129. It was observed that while the paragraph made provision for creditors to apply to the court for removal of the insolvency representative, it was often the case that small creditors in large cases could be essentially disenfranchised because they did not have sufficient economic interest in the proceedings to justify the cost of the application. To overcome that difficulty, it might be possible to pay the costs from the estate if the application was successful.

Paragraph (8) – appointment of a successor insolvency representative

130. Some reservations were expressed as to the need to include the second sentence of the paragraph, although it was pointed out that since different approaches were taken to that issue and that in some systems the assets were vested in the insolvency representative, the issue of succession would need to be addressed.

131. It was suggested that paragraph (8) could be combined as a subparagraph of paragraph (7) and that additional reasons be added to include illness and any other reason for which the insolvency representative might have to cease performing its duties. It was also suggested that in any case where the insolvency representative was replaced or removed, an obligation might be required to ensure books, records and other information were handed over to the successor.

C. Post-commencement financing[5]

132. With regard to post-commencement financing it was generally agreed that the draft Guide should address the importance of facilitating the availability of that finance in the context of reorganisation, sale of the debtor as an ongoing concern, or liquidation of the assets of the debtor, while taking into account the various approaches to the provision of priority taken by different jurisdictions.

Paragraph (1) – purpose clause

133. A number of suggestions were made regarding the stated purpose of obtaining post-commencement finance. It was suggested that elements to be mentioned in paragraph (1) should include the facilitation of obtaining post-commencement finance for the continued operation or survival of the business of the debtor, the preservation or enhancement of the value of the assets of the debtor, and to provide appropriate protection for persons who provide such finance or those persons whose rights are effected by its provision. In that regard it was suggested that the draft Guide should state that a purpose of the provisions was to strike a balance between granting payment priorities as an incentive to attracting post-commencement finance and the rights of existing creditors. It was further suggested that the draft Guide should clarify that the decision to obtain post-commencement finance should also extend to the provision of trade credit.

Paragraph (2) – availability of post-commencement finance

134. It was suggested that paragraph (2) should not only recognize the need for post-commencement finance, but should encourage a determination to be made at an early state as to whether the new finance was warranted or whether the business should be liquidated, since that decision was in fact the most important decision. It was noted that paragraph 191 of the draft Guide recalled the discussion at the twenty-fourth session of

---

[5] Reference document A/CN.9/WG.V/WP.58, paras. 187-191 and Summary and recommendations following.

the Working Group concerning the desirability of distinguishing between the different phases of the insolvency process in terms of the need for providing finance. It was observed that the availability of new credit might be of particular importance in the period between the making of the insolvency application and the commencement of the proceedings in order to keep the business operating. One example was noted where new credit could be obtained in this period provided it was determined to be "indispensable" to the debtor. It was suggested that the availability in that period might differ depending upon whether the proceedings were voluntary or involuntary; where the proceedings were involuntary, it was suggested that there was no need to consider the issue until commencement of the proceedings. The view was expressed that post-commencement finance was also important, for similar reasons, in the period between commencement and consideration of a reorganization plan. The availability of finance for the period after approval of the plan was a matter to be addressed in the plan.

135. In the context of liquidation, it was suggested that the availability of finance should not be limited to those situations where the business was to be sold as a going concern, but more generally in order to ensure payment of wages or insurance renewals, rent, maintenance of contracts and other debts which might be justified by the ongoing conduct of the business or the need to protect the value of assets.

136. In addition to distinguishing the different stages of the process at which new finance might be required, it was suggested that there may be a difference in the body that could authorize such finance. Prior to approval of the plan, the insolvency representative might be given the authority to approve, whilst after approval decisions could be subject to oversight by creditors or by the court. It was observed that the rationale of limiting the availability of post-commencement finance and requiring its authorization was based upon possible creditor prejudice and it should be made clear in the draft Guide that the existing rights of secured creditors should not be adversely effected by the provision of new credit. In any event, it was suggested that the requirement for authorization should be linked to the damage that may occur or the benefit that is provided as the result of the provision of new finance and that only those parties likely to be affected should be given an opportunity to object and to be heard.

Paragraph (3) – insolvency representative's powers

137. A number of suggestions were made regarding the substance of paragraph (3). As an initial matter, the view was expressed that paragraph (3) should be wider and provide that the insolvency representative may obtain post-commencement finance if it was determined to be necessary for the preservation or enhancement of assets not just for the continued operation of the business as provided in the current draft.

138. The view was stated that paragraph (3) as currently drafted seemed to vest broad discretion in the insolvency representative regarding decisions to authorize post-commencement finance and to grant security. It was generally observed that in many jurisdictions those decisions were a matter for the court, not the insolvency representative, although it was pointed out that the court would in any event have to rely upon the information provided by the insolvency representative as to the need for additional finance. Requiring the court to be involved in those circumstances simply added an extra step to the process. As to the provision of security, it was suggested that that would only be a problem in cases where the loan was not repaid. Another view was that having the draft Guide provide for early court involvement in decisions to obtain post-commencement financing could promote transparency and provide additional assurance to potential lenders. To address those differences, it was suggested that a threshold as to the amount of financing could perhaps be set above which authorization

would be required or that authorization would be required only in those situations where there was objection to what was proposed by the insolvency representative with respect to obtaining finance.

Paragraph (4) – priority

139. The Working Group agreed that the issue of the type of priority to be granted in the case of post-commencement finance was not a matter for the insolvency representative, but rather one which should be established in the insolvency law. As a general view, it was suggested that the priority to be accorded to new finance should be an administrative priority, although it was observed that suppliers of goods and services to the insolvent business should be encouraged to continue providing supplies and therefore be paid for what they supplied ahead of secured creditors. In terms of goods and services, it was also suggested that the reference to "credit" was too narrow and needed to be expanded. It was noted that paragraph (4) should recommend to those jurisdictions that grant a higher priority to certain classes of claims (such as payments to employees) than to administrative claims or unsecured creditors that those priorities be set forth or referred to in the insolvency law.

Paragraph (5) – treatment of existing securities

140. At the outset of the discussion it was suggested that the difference between paragraphs (4) and (5) needed to be clarified; paragraph (4) did not address existing securities, while paragraph (5) was only related to those securities. The view was stated that since existing secured creditors were generally unlikely to consent to granting another creditor a priority over the same security, paragraph (5) seemed to give existing security holders a veto that could operate to promote liquidation by posing an obstacle to the obtaining of post-commencement finance. A different view was that in some systems secured creditors would grant that priority because it served their best interests to do so to facilitate the reorganization, avoid litigation and enhance their prospects of payment. It was suggested that the difference in approach might depend upon whether or not secured creditors were left to enforce their security outside of the insolvency process.

141. It was observed that in some jurisdictions, the court could grant such a priority if it determined that the secured creditor had sufficient security in the assets that it would not be harmed by the priority to be given to the post-commencement finance. In other jurisdictions the court had to be satisfied that additional conditions were fulfilled including that the secured creditor was given notice and the opportunity to be heard by the court, that the debtor could prove it could not obtain the necessary finance in any other way and that the interests of the secured creditor would be adequately protected. Another view was that paragraph (5) should establish the general principle that existing security interests should not be effected by post-commencement securities without the consent of the secured parties, but where that consent was withheld, the draft Guide should indicate alternative approaches for obtaining post-commencement finance. It was further suggested that the requirement of the form of the consent should be a matter for general domestic law rather than being addressed in the draft Guide.

D. Creditor committees[6]

Paragraph (1) – purpose clause

142. It was suggested that the purpose of provisions on creditor committees should include at least (i) to facilitate the involvement of the general body of creditors by way of representation and (ii) to provide for appointment and functions of the committee.

Paragraph (2) – appointment of the creditor committee

143. The Working Group agreed that the presence of a creditor committee might contribute to the transparency of the procedure and that it was therefore desirable to encourage its appointment and to enhance its role. Accordingly, it was suggested that the word "may" be replaced by the word "shall". Another view was that the focus should be upon representation of creditors rather than on facilitation of the conduct of the proceeding.

144. Whilst agreeing on the general formulation of the provision, several views were however expressed to the effect that the terms "representation" and "to represent" be avoided. It was pointed out that in many legal systems that word would identify specific legal devices and effects which would not apply to creditor committees. The use of a more neutral phrase conveying the idea of representation, such as "for the purposes of the proceedings *vis-à-vis* the insolvency representative and the court", was therefore suggested.

145. It was observed that different categories of creditors were likely to have different and possibly conflicting interests and that it would not therefore be appropriate to provide for participation in a single committee of all type of creditors on an equal standing. Furthermore, since the most significant portion of debt, both in terms of number of creditors and amount of debt, was likely to be held by secured creditors, it was also likely that a unitary body would allow the latter to prevail and override unsecured creditors, irrespective of whether voting rights were based on number of creditors or amount of claims. Accordingly, for the purposes of preserving both the representative character and the effective functioning of the committee, different bodies should be provided in respect of the different classes of debtors. It was also noted that there may be small cases where creditors were often unwilling to serve or the number of creditors did not suggest the need for a committee, in which case the general body of creditors could perform the functions otherwise performed by a committee.

Paragraph (3) – functions of the creditor committee

146. Despite the differences that might occur in various legal systems, the Working Group agreed that the two functions typically performed by the creditor committee (i.e., the advisory and supervisory function) should be clearly set forth and elaborated to indicate what those functions might entail. One concern was that the committee should be able to actively represent and pursue the views of creditors, and should not be limited in its performance of those functions by the insolvency representative, only by the court. As a matter of drafting, a suggestion was that the reference to "expert" as a qualification of the advice to be given by the committee was inconsistent with the general scope of the advisory function that the committee was expected to perform and should therefore be deleted.

---

[6] Reference document A/CN.9/WG.5/WP.58, paragraphs 192-212 and summary and recommendations following.

147. A proposal was that the phrase "as directed by" appearing in the last sentence should be replaced by the phrase "in cooperation with", in order to more accurately reflect the relationship between the creditor committee and the insolvency representative. Related suggestions included that the draft Guide (i) clarify that in some systems the committee would operate in direct cooperation with and under the control of the court, and (ii) identify what mechanisms, if any, would apply in the event of a conflict between the committee and the insolvency representative.

Paragraph (5) – composition of the creditor committee and selection of members

148. As regards the order of the recommendations, it was observed that matters concerning the structure of the committee should be addressed prior to those relating to functions and that, accordingly, the order between paragraphs (3) and (5) should be reversed.

149. As a general remark, it was pointed out that the draft Guide should clarify the distinction between the creditors committee on the one hand, irrespective of the structure and prerogatives it might be given in various legal systems, and the general body of creditors or creditor's assembly as a whole, and that powers and functions given to the first should not impair the rights of the creditors as a whole to participate or otherwise act in the insolvency proceeding.

150. Support was expressed for the view that participation be restricted to a limited number of creditors, to be determined by national legislators, in order to preserve the effective functioning of the committee. The proposal that creditors in a situation of conflict of interest be excluded from participation in order to ensure the independence of the body received support. In that connection, however, it was pointed out that that exclusion should apply not only to creditors related to the debtor but to any creditor who might have a personal interest with the potential to affect its impartiality in carrying out the functions of the committee, such as a competitor of the debtor.

151. Support was expressed for the view that the draft Guide identify the mechanism for appointment of the committee which could perhaps include election by the general body of creditors or appointment by the court and provide for replacement of members lacking the necessary skills or who acted negligently or inefficiently. It was however pointed out that in some legal systems the replacement of the members of the creditors committee was limited to situations of gross negligence and that a stricter rule might result in participation in the committee being discouraged.

152. Reference to "willingness to serve" appearing in the first sentence of the paragraph was felt to be redundant, since it would be inconceivable to appoint as member of the committee a creditor not willing or ready to serve on it.

Paragraph (4) – appointment of expert advisers

153. The Working Group agreed that it was for the court and not for the insolvency representative to approve the employment of specialist advisers upon a proposal of the creditor committee. It was noted that providing for accountability of the creditor committee *vis-à-vis* the court, as opposed to the insolvency representative, was important to preserve the independence of the body. Further suggestions included adding a mention of the positive economic impact that the appointment and the involvement of an expert would have on the proceedings.

Paragraph (6) – duties and liability of the members of the creditor committee

154. The prevailing view was that it was not necessary to explicitly mention the duty of the members of the creditor committee to act in good faith, since good faith, as a

general principle of law, would apply to the performance of all duties. The concern was reiterated that the standard of liability imposed on members of the creditor committee should not be too high, in order not to discourage participation.

155. The suggestion that creditors having a conflict of interest be explicitly excluded from participation in the committee was also reiterated. It was pointed out that the issue might be especially relevant in respect of the claims sold after commencement of the proceedings on the secondary market, whose holders' interests would likely differ from those of the original creditors. In that connection, it was suggested that where a member of the committee sold its claim, the purchaser should not automatically succeed to the membership of the creditor committee, but that participation in the committee would be conditional upon the purchaser satisfying all relevant requirements.

156. Reference to the "fiduciary duty" of the members of the committee, *vis-à-vis* either the creditors or the shareholders or owners of the debtor, was found to be misleading in respect of some legal systems. Accordingly, it was suggested that it should be replaced by a more neutral phrase conveying the basis of the possible liability of those members. Another view was that the last sentence of the paragraph, providing for the exclusion of any duty of the creditor committee to shareholders or owners of the debtor, might not accurately reflect some situations arising in the context of reorganization where there would be a return to shareholders or owners and an exception for creditors having an economic stake in the outcome of the proceedings should be included.

Paragraph (7) – decision-making of the creditor committee

157. Although it was suggested that it might be inappropriate for the draft Guide to recommend a specific mechanism for the voting of the committee, support was expressed for the view that the creditor committee be required to establish by-laws governing its functioning and its decision-making process, possibly providing for different rules in respect of various types of decisions. It was noted, for example, that the creditor committee might be given the task of negotiating a plan on behalf of the general creditor body and their decision as to whether a particular plan might be appropriate to refer to the general creditor body might require a different majority to other types of decision taken by the creditor committee. A related proposal was that in establishing rules which might provide for the proportion that would constitute a majority vote, there should be no requirement for unanimity, since that might impair the functioning of the committee and ultimately the flexibility of the proceedings. A different view was that the provision should be deleted, given the variety of solutions which might be given under the various legal systems.

158. It was pointed out that paragraph (7) addressed only decisions falling within the scope of the powers and functions of the creditor committee and was not intended to make those decisions binding on or otherwise able to affect the powers of the general body of creditors, such as the power to approve a plan for reorganization. In that connection, it was reaffirmed that the powers of the creditor committee derived from those vested with the general body of creditors as a whole. It was suggested that the relationship between the general body of creditors and the creditor committee should be reflected in the structure of the recommendations, by reversing the order of the paragraphs respectively addressing the general body of creditors (current paragraph (8)) and the creditor committee.

Paragraph (8) – vote by the general body of creditors

159. Without prejudice to the decision set forth above as to the order of the paragraphs, a suggestion was that the recommendation on the general body of creditors should allow

for the provision of different majority rules in respect of different types of decisions. While an ordinary majority rule might be sound in respect of most decisions, a qualified majority would be more appropriate for more significant decisions, such as decisions concerning the insolvency representative or issues of post-commencement financing.

160. Support was expressed for addressing the powers and functioning of the general body of creditors in a separate section of the draft Guide, possibly in a chapter on issues relating to creditors.

E. Claims of creditors and their treatment[7]

Paragraph (1) – purpose clause

161. General support was expressed for the purpose of the provisions on treatment of creditors' claims as set forth in paragraph (1). It was suggested that subparagraph (d) might be more appropriate for the purposes provision of distribution priorities under Chapter V.A.

162. The Working Group agreed that paragraph (1)(a) should be drafted in broader terms than the reference to the insolvency representative, with a view to reflecting the various available options as to who was to consider claims.

163. Reference to the provisions for "appeals" appearing in paragraph (1)(b) and in other paragraphs of the Summary and recommendations section was felt to be inappropriate. Since in a number of legal systems that term pointed to a specific procedural means of judicial recourse, the use of a more neutral phrase, such as "judicial recourse", was supported.

164. As to paragraph (1)(c), a suggestion was that reference to similar classes of claims, such as disputed, conditional or non-monetary claims, should also be included, provided, however, that the list would not purport to be exhaustive.

Paragraph (2) – treatment of foreign creditors

165. A drafting suggestion was that the provision be aligned with the terminology of the UNCITRAL Model Law on Cross-border Insolvency, where the distinction between national and foreign creditors was based on residence rather than nationality.

166. With a view to preserving the equal treatment of foreign creditors, the Working Group agreed that the notification of the proceeding should explicitly set forth not only the deadline for submission but any and all procedures and form requirements necessary for the submission of the claim, provided that the identification of those procedures be left to national laws. Nevertheless, it was felt that the purpose of equal treatment of foreign creditors might be frustrated if personal appearance of the creditor before the insolvency representative were required and it should therefore be discouraged with respect to the submission of the claim.

167. A suggestion, particularly for the benefit of foreign creditors, was that the notification should indicate whether the value of the claim would be considered by reference to the application for, rather than commencement of the proceedings, since that might affect the conversion of the currency in which the claim was expressed.

---

[7] Reference document A/CN.9/WG.5/WP.58, paragraphs 213-252 and Summary and recommendations following.

Paragraphs (3) and (5) – submission of claims

168. The Working Group agreed that the issue of the time for the submission of the claim addressed in paragraph (3) was also dealt with in the first sentences of paragraph (5) and that, accordingly, the two provisions should be jointly discussed.

169. Support was expressed for the suggestion that national legislators be encouraged to provide for the submission of claims either within a specific time after commencement or at any time prior to distribution. It was pointed out that the consequences applying upon failure to submit the claim within the provided time should be explicitly addressed and identified in the law, since many options, including subordination of those claims, were available. With a view to highlighting the need for the provision of sanctions in the insolvency law, it was suggested that paragraph (3) be amended by replacing "may" with "must". It was also suggested that contractually subordinated claims should be addressed.

170. It was also suggested that it was not for the insolvency law to establish the substantial or procedural treatment that would apply to a claim which was not submitted to the insolvency proceeding, but rather a matter to be addressed under other relevant national laws. While forfeiture of unsubmitted claims would be acceptable where the insolvency law provided for discharge of the debtor upon closing of the proceedings, failure to submit would not otherwise affect the possibility of enforcing those claims, or the part of them which had not been satisfied in the procedure, under general substantive and procedural rules once the insolvency proceeding was completed. A similar proposal was that the issue be dealt with in the context of the discussion of discharge, currently addressed in paragraph 298 of the Commentary. A suggestion was also made that claims, including claims by secured creditors, should be submitted early in the proceeding to enable the debtor and the insolvency representative to determine the scope of the pre-commencement claims against the insolvency estate.

171. Several concerns were expressed in respect of the last sentence of the paragraph, providing for submission of a claim by a secured creditor only when that creditor had surrendered its security or the claim was undersecured. It was observed that submission which was conditional upon the value of the claim exceeding the security might result in great uncertainty, since that evaluation could be made on the basis of different standards (e.g. insolvency or market value) and at different points in time. It was further noted that providing that the obligation to submit a claim applied to all creditors, whether secured or unsecured, was necessary to ensure that the insolvency representative would be aware of all secured claims and the amount of outstanding debt. Another view was that submission of secured claims could be avoided in respect of those securities resulting from a public registry only. The Working Group agreed that the draft Guide should recommend that the treatment of secured creditors for the purposes of the submission of claims be clearly set forth in the insolvency law.

172. A concern was expressed that reference to claims to be made "against the estate" appearing in the first sentence of paragraph (5) might be misleading, since it might suggest the need for submission of claims for post-commencement debts. In response, it was clarified that paragraph (5) was only meant to address the filing of claims having arisen prior to commencement and the phrase "against the estate" should be deleted.

173. It was suggested that reference to the treatment of foreign creditors in the third sentence of the paragraph should appear as a separate paragraph.

Paragraph (4) – list of creditors and statement of claims

174. One view was that the debtor should assist the insolvency representative in drafting the list of creditors, as a significant aspect of its general duty to cooperate in the insolvency proceedings in respect of both liquidation and reorganization. It was observed that in some legal systems a list of creditors was a requirement for the filing of a voluntary application.

175. Several views were expressed as to the consequences which would apply to those creditors which the debtor failed to include in the list. In that connection, it was suggested that the draft Guide might clarify that the list, as drafted either by the debtor or by the insolvency representative relying on the information provided by the debtor upon commencement, would be subject to revision and amendment in a subsequent phase of the proceedings. In that respect, the Working Group agreed that the control of the list by the insolvency representative and ultimately the court should be preserved.

176. A question was raised as to whether a creditor needed to file a claim where the debtor filed a list that admitted the claim. It was suggested that to regard a claim as admitted on that basis would entail the risk that the debtor might use its power to recognize one or more specific debts to the detriment of the equal treatment of creditors.

Paragraph (6) – excluded claims

177. As a general remark, it was clarified that it was for general substantive and procedural law, as opposed to insolvency law or the insolvency representative, to determine which claims should be excluded. A suggestion was that the insolvency representative should consider all outstanding claims to be included in the list pursuant to applicable substantive and procedural law. A drafting suggestion was to delete the word "may" which might inappropriately suggest that the insolvency representative had a discretionary power with regard to those claims.

178. The example of gambling debts was felt to be inappropriate, since the treatment of gambling was different under the substantive law of various legal systems. It was suggested that foreign revenue claims should be treated in a manner consistent with the UNCITRAL Model Law on Cross-Border Insolvency.

179. Several views were expressed as to the desirability of the draft Guide addressing the treatment of specific classes of claims, including (i) fines or other (administrative) claims which might be excluded from the insolvency proceedings because the amount would overwhelm the insolvency estate; (ii) claims which were not due upon commencement; (iii) punitive damages; (iv) claims not determined in their amount upon commencement, such as tort claims or contingent claims for environmental violations; and (v) disputed claims.

180. After discussion, the Working Group agreed that the draft Guide should avoid providing a list of excluded claims, but rather recommend that those claims be clearly identified and set forth in national law.

Paragraph (7) – evidence of claims

181. As to the right of the creditor to give evidence of its claim by way of declaration or affidavit, one view was that that approach would be an exception to the general rule requiring each creditor to give evidence of the submitted claim, a matter which should rather be addressed and governed by national procedural laws. Another view was that the provision, if retained, would need to be supplemented by qualifications as to the circumstances entailing its application. A further view was that the addressee of a declaration or affidavit stating a claim would be the court and not the insolvency representative.

182. It was observed that not all legal systems were familiar with the use of affidavit and similar declaration as a means of evidence. It was further noted that as a means of evidence an affidavit was expensive and therefore less and less used even in those systems where it would be admitted. As a general remark, the Working Group was reminded that the more the detail included in the draft Guide, especially in respect of procedural issues, the greater the difficulty of making it acceptable in different legal systems. Accordingly, it was proposed that the provision be given a wider scope, by enabling each creditor to give evidence of its claim in writing without personally appearing before the insolvency representative or the court. In that connection, it was reaffirmed that specific directions as to the way in which evidence of claims was to be given, as well as on any other applicable procedural requirement, should be provided to creditors within the context of notification of commencement of proceedings.

183. A further suggestion was that the filing of false claims should be explicitly sanctioned.

Paragraph (8) – admission and rejection of claims

184. As regards the issue of admission of claims, there was agreement that admission should not occur automatically, but would require a decision by the insolvency representative. Accordingly, the reference to claims which might be admitted automatically in the second line of the first sentence of the paragraph should be deleted. Some support was voiced for the suggestion that the draft Guide should recommend that the decision by the insolvency representative be taken in a timely manner, especially when the claim was supported by adequate documentation. The view that automatic admission be provided as an exception for claims registered in a public registry was not supported, nor was the suggestion that a distinction be drawn depending upon whether the claim could be immediately executed or not.

185. A further concern was that it would be inappropriate to rely on accounting records for the purposes of admission of claims, since it was unlikely that those records would be kept in a proper manner, at least as far as those of the debtor were concerned. It was observed that the reference to accounting records might also include those of the creditor and that they might be used for evidentiary purposes pursuant to the general rules on evidence, provided that admission would always be conditional upon approval by the insolvency representative. It was suggested that where claims were sufficiently established by accounting records, that would facilitate a quick decision by the insolvency representative as to admission or rejection.

186. As to the right to challenge the admission or rejection of a claim, evoked in the final part of the sentence, the view that reference to that right might encourage litigation was not shared. Support was expressed in favour of the right to challenge not being limited to creditors or the insolvency representative, but rather to include any interested party, such as creditors whose claims were disputed, the creditor committee and the debtor. In that connection, it was further clarified that creditors whose claims had been admitted were entitled to challenge the admission of other claims. The inclusion in the draft Guide of some detail as to the procedures for such a challenge, including providing for a hearing before a judge, was also suggested.

Paragraph (9) – provisional admission of claims

187. The Working Group agreed that since provisional admission of claims could have a significant impact on the proceedings, especially when voting rights were vested in creditors whose claims were admitted on a provisional basis, the issue warranted specific attention in the draft Guide.

188. Several views were expressed as to the scope of the various categories of claims mentioned in paragraph (9) as subject to provisional admission. It was agreed that the draft Guide should provide clarification as to whether (i) the notion of "claims of undetermined value" would encompass non-monetary claims; and whether (ii) "disputed claims" referred to claims that were subject to pending litigation outside of the insolvency, or rather to claims contested within the context of the insolvency proceedings.

189. Support was expressed for provisional admission of conditional claims, contingent claims and claims not yet mature at the time of commencement. In respect of the latter, however, it was clarified that admission should occur not on the basis of the face value of the claim, but rather of the basis of a deduction relating to the unexpired period of time before the claim matured.

190. With a view to enhancing clarity, support was expressed for the proposal that a general discussion of the claims qualifying for admission should be included in the draft Guide, to be followed by a discussion of those claims which, though lacking those characteristics, might be admitted on a provisional basis. In addition, it was pointed out that each category mentioned in paragraph (9) raised different issues of substantial and procedural treatment that might need to be addressed.

191. Strong support was expressed for placing the burden of the initial decision on the provisional admission of claims on the insolvency representative rather than on the court, without prejudice to the right of a dissenting party to have recourse to the latter. To enhance the expedition of the proceedings, it was suggested that the draft Guide adopt a general principle that the court should only be involved where strictly necessary.

192. As to the effects of provisional admission, the view was shared that the draft Guide should identify the rights vested in a creditor whose claim was admitted on a provisional basis. One suggestion was that those rights should be limited to the right to be heard before the court. In no event, it was felt, should provisionally admitted creditors be entitled to participate in a distribution.

193. With respect to the right of review of a valuation, it was observed that it was related to the right to review in paragraph (8) and it might be preferable to address the issue of review in a single provision. Whilst recognizing that paragraph (9) did not purport to address procedures for valuation, it was suggested that it would be appropriate for the draft Guide to deal with those issues and to indicate appropriate criteria.

Paragraph (10) – effects of the admission of a claim

194. As a preliminary remark, it was observed that the chapeau of the paragraph might suggest that all rights of the creditors were conditional upon the admission of their claims. That result would be inconsistent with the fact that all creditors having submitted a claim were at least entitled to participate in the first meeting of creditors and, accordingly, the text should be amended to that effect.

195. As to the scope of the paragraph, it was suggested that it be made clear that the reference to meetings of creditors was to the general assembly of creditors and that a creditor with an admitted claim should have all the rights and functions of that body, not simply the right to vote. General support was expressed for the view that those rights and functions should include at least the following: (i) approval or rejection of a reorganization plan; (ii) election of the creditor committee; and (iii) providing advice on appointment of the insolvency representative.

196. Further suggestions included the power of the general assembly of creditors to decide upon the following issues: (i) the relationship between the liquidation and the reorganization process; (ii) the distribution of the assets of the insolvency estate; (iii) post-commencement financing; (iv) compensation of professionals; (v) treatment of judicial proceedings which were pending and to which the debtor was a party upon commencement of the proceeding; (vi) the continuation of the business by the debtor; or (vii) the agreement on expedited restructuring. Finally, a view was that it would be advisable to include a general provision allowing national legislators to provide for further functions of the assembly of creditors, without prejudice to the need to balance those powers and functions against those of the other bodies and to preserve the flexibility of the proceedings.

197. In addition to addressing the functions of the general assembly of creditors, it was suggested that the draft Guide could address the relationship between that body and the creditor committee (where that body was constituted in the insolvency process) and which of the powers of the general assembly could be delegated to the committee.

198. In respect of paragraph (10)(a), a proposal was that reference to the right of an admitted creditor to participate in the appointment of a creditor committee should be added.

199. Various comments were expressed in respect of paragraph (10)(b). A concern was raised that reference to "payment to the creditor in a distribution" might point only to a liquidation and that payment pursuant to a reorganization plan should also be included. A further view was that reference to admission establishing the "amount" of the claim to be paid by the insolvency representative was incomplete and needed to be supplemented by a reference to the "priority" of the claim.

Paragraph (11) – right to set-off

200. Different views were expressed as to whether it was necessary to address the right to set-off in the context of the insolvency estate (as reflected in paras. 116-120 of the Commentary) or in both sections.

201. In response to the suggestion that set-off should be subject to the stay to allow the insolvency representative an opportunity to review the respective claims, it was noted that different substantive rules and procedural mechanisms addressing set-off were provided in the various legal systems. Given the sensitive nature of the issue, it was felt that an agreement on a unique solution would not be feasible. Nevertheless, it was pointed out that set-off entailed a significant exception to equal treatment of creditors and needed to be addressed. After discussion, the Working Group agreed that that the draft Guide should clarify if and to what extent the general rules on set-off might be affected by insolvency law, by presenting the various available options without suggesting a specific rule. A specific mention of the need to preserve the operation of set-off for the purposes of financial netting was noted.

Paragraph (12) – claims by insiders and shareholders

202. Several views were expressed to the effect that the reference to "shareholders" of the debtor was too narrow, since it pointed at one specific form of incorporation of a company, and that a broader term capable of encompassing all possible types of stakeholders (e.g., either in companies or partnerships) was needed. As to the meaning of insiders, it was suggested that that term needed some clarification as to who it was intended should be included.

203. As to the substantive treatment to be provided in respect of those persons, one view was that their voting rights should be restricted. A different view was that all claims held by insiders or stakeholders should be subordinated. In response, it was suggested that subordination of all of those claims might discourage insiders and stakeholders from providing finance for the benefit of the debtor, a result that would significantly reduce the chances for many debtors to obtain fresh funds and redress their financial situation. Accordingly, it was suggested that subordination should apply only upon evidence of improper behaviour. A further suggestion was that a decision in that respect should be taken by either the insolvency representative or the court upon examination of the circumstances under which the loan had been granted. Another suggestion was that subordination be provided in respect of claims related to inadequate capitalization of the debtor rather than to loans granted to a company in financial distress.

204. After discussion, the Working Group agreed that the issue should be discussed further at a later stage when a specific text had been drafted.

5. Liquidation and distribution

A. Distribution priorities

205. As an initial matter it was suggested that the title of the section on liquidation and distribution should be revised to clarify that its focus was on the distribution of assets realized upon liquidation, rather than on specific liquidation issues which were not addressed in the section. The view was expressed that the draft Guide should draw a distinction between those cases where the business ceased operations and the assets were sold, and those cases where the business was kept in operation but components were sold off as going concerns, and focus only upon the forced sale situation in the section. The other alternative should be addressed in the context of sale of assets, a topic not addressed elsewhere in the draft Guide in any detail. It was suggested that the draft Guide should make clear that the insolvency representative should make distributions promptly, rather than delaying disbursement in order to attempt to maximize the amount available for distributions as a result of fluctuations in the relevant market and that distributions could be made on an interim basis.

206. A number of suggestions were made regarding the order in which payments would be made to various categories of claims. Some concern wase expressed about the inclusion of secured claims and what was actually intended in that regard. A related concern was that the categories of claims listed in paragraph (2) should be reordered to provide that the expenses of the insolvency representative should be listed first, followed by other administrative claims which arose as a consequence of the insolvency proceeding, and then claims that arose prior to the commencement of the insolvency, such as secured claims. It was also suggested that no distinction should be made between different types of administrative claims. It was noted that other categories of claimants should be considered, such as those of third parties whose property was held by the debtor, claims that are given special recognition under domestic law, such as employee and tax claims, and claims that might be satisfied otherwise than by payment of money. The view was stated that the draft Guide should include a general recommendation to the effect that priorities should be kept to a minimum and that where they were granted by operation of law other than insolvency law, legislators should be encouraged to list those priorities in the insolvency law to enhance predictability. A further issue raised was the need to address the treatment of surplus funds in those cases where the debtor was solvent and there may be a distribution to owners, shareholders and others, and whether

interest on other claims would rank ahead of such a distribution. After discussion the Working Group generally agreed that the draft Guide should not present a hierarchy of claims for distribution, but rather illustrate types of claims that legislators may wish to consider.

207. It was noted that the provisions in paragraph (3) regarding the equality of claims within a claims class and the payment of a class in full before the next class was to be paid, although applicable in respect of some types of claims, were inapplicable in the case of secured claims.

B. Discharge

208. It was noted that the position as to the discharge of the debts of an individual debtor following the conclusion of insolvency proceedings varied among jurisdictions. The view was stated that the draft Guide should reflect the range of policy choices between, on the one hand, the automatic discharge of the debtor and on the other hand, the possibility of continued court supervision. It was suggested that more examples of different approaches should be discussed in paragraph 258 of the Commentary. With regard to some of the different factors which might determine how a particular debt was treated, it was noted that the conduct of the debtor in the insolvency proceeding might be one of a number of such factors and that a direct link to the debtor's obligation to cooperate could be made. That approach might result in certain categories of debt not being subject to the discharge for reasons such as that they were not disclosed by the debtor.

6. Reorganization plans[8]

Paragraph (1) – purpose clause

209. Various views were expressed on the purposes of the provisions relating to the reorganization plan as set forth in paragraph (1). Support was expressed in favour of addressing the need to provide adequate information in respect of both the situation of the debtor and the treatment of creditors under the plan, to allow creditors to make an informed decision on the plan.

210. Another view was that the provision as drafted might be redundant, since most of the issues mentioned in paragraphs (1)(a) to (1)(f) were specifically addressed in the recommendations that followed. It was further pointed out that many of those issues pertained to the technical mechanisms and devices concerning the implementation of the plan rather than to the purposes of the provision. Accordingly, it was suggested that the provision should be replaced by a general statement to the effect that the provisions on the reorganization plan were aimed at facilitating the proposal, submission and approval of a reorganization plan.

211. Support was expressed for the suggestion that the provision on the purpose of reorganization be based upon the general statements contained in the preamble to the UNCITRAL Model Law on Cross-Border Insolvency, providing for "facilitation of the rescue of financially troubled businesses, thereby protecting investment and preserving

---

[8] Reference document A/CN.9/WG.5/WP.58, paragraphs 261-299 and Summary and recommendations following.

employment". A further view was that reference to the objective of maximization of assets should also be included.

212. On the assumption that the structure of the paragraph be retained, support was expressed for an additional provision as to the binding effect of the plan being conditional upon its approval being included between paragraphs (1)(a) and (1)(b).

213. As to paragraph (1)(a), a drafting suggestion was that explicit reference to both secured and unsecured creditors be added.

214. As to paragraph 1(b), a proposal was that stakeholders of the debtor should be included among the categories possibly affected under a plan. Another suggestion was that reference to "all" creditors was inaccurate, since not all creditors would necessarily have their rights or positions modified under a plan. A different view, however, was that the term "all" might usefully point to the binding effect of an approved plan on dissenting creditors.

215. Several views were expressed to the effect that mention of discharge of debts and claims in paragraph (1)(f) was inappropriate, since discharge was only one of the various solutions which might be proposed under a reorganization plan and would not qualify as an objective for reorganization.

216. After discussion, the Working Group agreed that the structure of the provision should be retained, provided a clear distinction were drawn between purposes and implementation techniques and that reference to all relevant issues which might arise in the context of a plan be addressed.

Paragraph (2) – time of submission of the plan

217. As a preliminary remark, it was suggested that the draft Guide should clarify that both paragraphs (2) and (3) dealt with plans prior to approval and should therefore more appropriately refer to a "proposal for a plan". A contrary view was that the word was commonly understood as encompassing a reorganization plan throughout the different phases of the procedure and that no amendment to that language in the draft Guide was desirable provided its usage was made clear.

218. The Working Group agreed that the issue of the time of submission of the plan should be dealt with in a separate paragraph from the issue of who was entitled to formulate a plan.

219. The view that the draft Guide should recommend the timely submission of the plan was shared by the Working Group, although different views were expressed as to the desirability of a establishing a fixed time period for submission. Support was expressed in favour of a deadline being determined by the law, with a view to preserving the overall goals of predictability and transparency. A different view was that a more flexible approach, allowing the court or the insolvency representative to determine that deadline, would be preferable. Intermediate proposals were that the court might be allowed to establish that term within a maximum period established by the law, or that the court be allowed to extend the deadlines provided in the law.

Paragraph (3) – preparation of the plan

220. As to the mechanism for determining who might prepare a plan, one suggestion was that allowing proposals to be contemporaneously presented by different parties might lead to the procedure being more efficient, while a procedure which provided for a sequenced approach could lengthen the procedure unnecessarily. A contrary view was that to establish order in the process, one party, be it the debtor or some other party,

should be given a short exclusive period to file, after which other parties could be given the opportunity if no plan was forthcoming or the plan proposed was likely to be unsuccessful. The view was expressed that in order to encourage debtor to apply for commencement of proceedings at an early stage, it should be the debtor who was given the exclusive opportunity.

221. Although the view was expressed that the formulation of a plan by the debtor was not provided under all legal systems and was therefore inappropriate, the prevailing view was that the draft Guide should reflect various options, including presentation by the debtor, the creditors, the insolvency representative, either alone or in cooperation with the debtor, as well as by any other interested party, such as a competitor of the debtor. It was suggested that the provision referring to the filing of the plan on application should be permissive, not mandatory.

222. A concern was raised as to the debtor being entitled or required to consult "with the creditors and the insolvency representative" prior to proposing a plan, as envisaged in the second sentence of paragraph (3). It was felt that consultations with the creditors might create situations of conflict of interest and that only consultations with the insolvency representative should be considered. A similar view was that, although prior consultation with the creditors might enhance the chances of the proposed plan being approved, it would be more appropriate for the insolvency representative rather than the debtor to conduct those consultations. A further view was that a collaborative process might lead to the best result in terms of an acceptable plan.

223. On the question of establishing a link between a reorganization plan negotiated and agreed upon by the debtor and the creditors in an out-of-court context and the filing of a reorganization plan within an insolvency procedure by the debtor, it was suggested that the two issues should be separately addressed in the draft Guide because of the financial situation of the debtor: in some insolvency systems, out-of-court procedures were only possible if the debtor was not insolvent.

Paragraph (4) – contents of the plan

224. General support was expressed for the view that the insolvency law should specify the contents of a reorganization plan, with a view to ensuring that essential detail as to the consequences entailed for the various classes of creditors, as well as for other parties in interest, be provided. As to the specific contents, a number of suggestions were made, including that the plan address issues such as (i) the classes of creditors and the treatment respectively provided for each of them (including timing of payment where that was provided); (ii) the treatment of contracts, including employment contracts; and (iii) the possible sale of the business as a whole or of any envisaged changes in the capital of the insolvent company.

225. Support was also expressed for the suggestion that the descriptive information appearing in square brackets and italics in the second sentence of the paragraph be required to be included in a disclosure statement to be filed jointly with the plan, rather than be included in the plan itself. The disclosure statement should include, amongst other things, details as to the debtor's assets and liabilities, proposed treatment of creditors, proposed payment to creditors and the post-reorganization plan of the debtor as to the operation of the business or liquidation of the debtor's assets.

Paragraph (5) – classes of creditors

226. A concern was expressed that reference to the "nature and content" of the rights as the criteria for division of creditors in classes might be too narrow and that a reference to priorities or debt obligations or the nature and extent of debt should be included.

227. It was pointed out that since in some legal systems the often large number of creditors holding small claims were grouped in a single class, a solution which often enhanced the expeditiousness of the procedure, that approach could be mentioned in the draft Guide.

Paragraph (6) – approval of the plan

228. In respect of paragraphs (6)(a) and (b), support was expressed for the view that reference to classes was misleading, since it might raise doubts as to the relationship among classes, an issue addressed under paragraph (8) and would need to be clarified.

229. A suggestion was that the provision clarify that only creditors whose claims had been admitted could vote.

230. A view was that the term "affected" in paragraph (6)(a) was not appropriate because while all creditors were affected by the insolvency proceedings, what was intended here was to refer to those cases where the rights of secured and priority creditors might be modified either because the law provided that they could be or because the creditors agreed to modification. That modification may relate, for example, to extending the period of repayment of the debt and interest.

231. A suggestion was that the term "secured creditor" should be clarified by introducing a definition, since the expression might point at different situations within the various legal systems. It was also suggested that the rights and obligations of secured creditors were essentially individual and it might perhaps not be appropriate to refer to them as a distinct class.

232. In respect of paragraph (6)(b), a suggestion was that the reference should be to "ordinary" rather than to "unsecured" creditors.

233. A view was that approval by the majority of shareholders provided under paragraph (6)(c) would only be appropriate for those situations where the debtor proved to be solvent, since otherwise shareholders would have no stake and would not be entitled to vote or to otherwise participate in any distribution of the assets. Accordingly, it was suggested that the provision be deleted. A different view was that the voting right of shareholders should be preserved as a means of control on the directors and managers of the company. A further view was that treatment of shareholders might be addressed in a comprehensive manner in a broader section dealing with the treatment of their claims.

234. Recalling an earlier discussion in relation to paragraph (12) of the section on creditors' claims, the Working Group agreed that reference to the term "shareholders" should be modified to a term capable of encompassing all possible types of stakeholders (e.g., in companies or partnerships).

Paragraph (7) – voting majorities

235. Some support was expressed for the view that the paragraph as drafted was too specific and that the draft Guide should rather concentrate on providing alternatives, along the lines set forth in paragraph 279 of the Commentary and indicate those solutions that were not desirable, such as unanimity or simple majorities based on number of creditors. In addition to establishing what might constitute a sufficient vote for approval of the plan, it was suggested that the Summary and recommendations section should also address the manner in which that vote might be obtained (whether by physical attendance at a meeting of the general body of creditors or by mail or some other means). It was observed that the method of voting might in turn influence the majority required; if the vote was obtained by mail, a simple majority might be sufficient, while if voting occurred at a meeting of creditors, a qualified majority might be necessary. A further

suggestion was that the insolvency representative might have a role to play in achieving the necessary vote and perhaps providing a balance to the interests of the majority creditors.

Paragraph (8) – binding dissenting creditors

236. It was observed that as drafted the paragraph did not clearly distinguish between the situations where creditors in a particular class dissented from the majority vote of that class and where a class or classes of creditors dissented from the vote of the majority of classes. It was suggested that those two issues should be treated in separate paragraphs, the first addressing how dissenting creditors in a particular class might be treated and the second, which related to the role of the court in paragraph (9), how dissenting classes of creditors might be treated.

237. Although recognizing that the ability to bind creditors to a reorganization plan that was approved by the requisite majority was essential to the implementation of the reorganization, different approaches were noted with regard to how that occurred. Under some insolvency laws the vote of the requisite majority, both of creditors within a class and of classes of creditors, was binding upon all creditors without the need for any further step, such as court confirmation or approval. Under other laws, it was noted that since the reorganization plan was a contract, it could only be made binding on all creditors, particularly those who did not support it and those who did not vote on it, by virtue of a court order.

Paragraph (9) – confirmation of the plan

238. Recognizing the different approaches indicated in the context of the discussion of paragraph (8) on the need for court confirmation of the plan, the Working Group discussed what the court might be required to consider in performing that confirmation. One view was that the court should confine itself to matters such as the proper conduct of the approval process; that creditors would receive at least as much under the plan as they would have received in liquidation; where dissenting classes of creditors could be bound to the plan, that senior classes of creditors would be paid in full before payments to more junior classes unless they had agreed to some different approach; and the legality of the plan. Some concern was expressed at the suggestion that the court might be asked to consider the economic feasibility of the plan, especially where that might require the court to hire experts and consider economic matters in some detail. That situation should be distinguished from the question of the court considering the feasibility of the plan as discussed in paragraph 289 of the Commentary without considering economic issues in any detail.

239. It was observed that where confirmation of the plan was required for purposes of enforcement, the process was not necessarily one that required lengthy procedures or a full and complete analysis of the plan, but could be arranged so as to minimise costs and facilitate expedition.

Paragraph (10) – objection of creditors

240. It was observed that in some systems which did not provide for court confirmation paragraph (10) provided a necessary opportunity for aggrieved creditors to challenge the approval of the plan. It was also suggested that the paragraph might address the question of review of the court's confirmation of an approved plan.

241. Some support was expressed for the view that the paragraph should include grounds upon which the plan might be challenged, such as that the requirements for confirmation had not been met; that the plan provided for a lower return than liquidation;

or that the approval process was improper. A further view was that those grounds should be limited to cases of fraud so as to avoid the potential for undue interruption to the implementation of the plan. It was also observed that the paragraph should clearly indicate the time at which objections could be raised (i.e. post-approval and pre-confirmation or post-confirmation).

Paragraph (11) – supervision of implementation of the plan

242. It was suggested that some provision might be made to limit the time over which the court or some other supervisor might be involved where implementation was to occur over a lengthy number of years.

Paragraph (14) – termination of the plan

243. With regard to conversion to liquidation proceedings, some concern was expressed that that should not involve a completely new filing involving more delay and unnecessary procedures. One solution suggested was to allow a liquidating plan providing for the sale of assets to be filed in the reorganization. It was noted however, that where implementation of the plan failed after a considerable elapse of time since the reorganization proceedings had been commenced, new proceedings might be necessary. It was also suggested that the question of conversion should be addressed more generally as applying at any time during the reorganization proceedings and to cover situations such as where the debtor had no honest intent in commencing reorganization; where there was a continuing loss of assets and no prospect of reorganization; or where the debtor failed to observe its obligations with respect to the proceedings.

7. Consideration of other issues

A. Out-of-court and expedited court reorganization

244. The Working Group considered a note by the Secretariat on out-of-court and expedited court reorganization which had been prepared on the basis of the Working Group's earlier deliberations as follows:

> "Out-of-court restructurings and expedited court reorganization procedures have proven to be a cost efficient method of restructuring the financial obligations of financially troubled entities and as such can prove to be valuable tools in the range of insolvency processes available to a country's commercial and business sector. An out-of-court restructuring typically involves negotiations between the debtor and one or more classes of creditors. If a minority of affected creditors dissent or "hold-out", the dissentors can only be bound if reorganization proceedings are commenced under insolvency law and a reorganization incorporating the terms of the restructuring is approved by the court. The benefits of the out-of-court restructuring process can be preserved if the reorganization proceedings can be expedited in such a situation.
>
> "Encouraging out-of-court restructurings need not stem from the fact that a country's formal insolvency system is poor, inefficient or unreliable, but rather from the advantages such restructurings can offer as an adjunct to a formal insolvency system which delivers fairness and certainty. Expedited court procedures could be utilized when a substantial number of creditors have reached agreement with the debtor but unanimity has not been achieved. .

"Out-of-court processes

"It has been suggested that the draft Guide on insolvency law should include a discussion of the various processes other than full reorganization proceedings under insolvency law which should normally be available to deal with the financial difficulty or insolvency of a commercial enterprise. This discussion should incorporate reference to texts which have been developed to assist the conduct of the out-of-court portion of these processes, such as the INSOL Principles for a global approach to multi-creditor workouts, and also discuss the interrelationship between such informal processes and reorganization proceedings under insolvency law.

"Out-of-court restructurings predominantly involve restructuring of debt due to lenders and other institutional creditors. They also however, frequently involve major non-institutional creditors, typically where such creditors' involvement is so considerable that an effective restructuring is not possible without their participation.

"Another essential characteristic of out-of-court restructurings is that they do not generally involve all categories of creditors. It is usual for non-institutional creditors (other than those referred to in the previous paragraph) to be paid either in the ordinary course of business or in full under the reorganization plan. Those creditors are not likely to have any objection to the proposed restructuring and do not need a voice in the process.

"Expedited reorganization proceedings

"A need for court involvement to implement a restructuring that has been negotiated in an out-of-court process arises from the existence of a dissenting minority of creditors that the debtor and the majority wish to bind. This requires a non-consensual modification of contractual rights that can only be achieved by due process requirements that protect the creditors in a court proceeding.

"Under most existing legal systems, a modification of contractual rights requires the out-of-court restructuring to be converted to a full reorganization proceeding under the insolvency law, involving all creditors. Timing is typically critical in business reorganization and delay (usually inherent in full insolvency proceedings) can frequently be fatal to an effective reorganization. It is therefore important that the court takes advantage of any negotiations and work done prior to the commencement of reorganization proceedings under the insolvency law and that the insolvency law permits the court to expedite those reorganization proceedings.

"The draft Guide should include the procedure for implementing a restructuring that has been previously negotiated in an out-of-court process by means of a formal proceedings and develop provisions under the insolvency law to facilitate expedited reorganization proceedings by providing:

> "(a) For a quicker process. For example, if an informal plan and other documentation that complies with the formal requirements of insolvency law has been negotiated informally and there is a substantial majority in favour, it would be possible for the court to order an immediate meeting or hearing as applicable, saving time and expense;

"(b) For an exemption to be granted from part of the formal process. For example, if an informal plan has been agreed by a sufficient majority of creditors of a particular class to approve a reorganization under the voting requirements of the insolvency law – typically the institutional creditors – and the rights of other creditors will not be impaired by the implementation of the plan, it might be possible for the court to order a meeting or hearing of that particular class of creditors only.

"There is no intention, however, to recommend less protection for non-assenting creditors and other parties under expedited court reorganization procedures than insolvency laws provide in full reorganization proceedings. The procedural requirements for expedited reorganization proceedings must contain substantially the same safeguards and protections as provided in full reorganization proceedings.

"Other laws may need to be modified to encourage or accommodate out-of-court restructuring and expedited reorganization proceedings. Examples of such laws would include those that require unanimous consent to adjust indebtedness outside of insolvency proceedings, that expose directors to liability for trading during the period when an out-of-court restructuring is being negotiated, that do not recognize obligations for credit extended during such a period and that restrict conversion of debt to equity."

245. The proposal to address those processes in the draft Guide was generally supported. In particular, support was expressed for including in the draft Guide a discussion of out-of-court processes, including a consideration of the circumstances in which such processes might be used, the parties that might be involved and the existing mechanisms for facilitating their conduct. With respect to the expedited court procedures, support was expressed for establishing how the out-of-court process could be integrated into the expedited reorganization proceeding and it was suggested that what needed to be developed were the details of the proposal including the situations in which such a procedure might be used, the criteria that would trigger its use and the safeguards for creditors that would need to be included.

246. The Secretariat was requested to develop the details of the proposal for consideration by the Working Group at a later meeting.

B. Scope of the insolvency law

247. The Working Group considered paragraphs on scope of the insolvency law which had been revised on the basis of its earlier deliberations as follows:

"The purpose of provisions on eligibility and jurisdiction is to determine:

"(a) which types of debtors can be subject to the insolvency law;
"(b) which types of debtors require specialized treatment and should therefore be covered by a specialized insolvency regime and excluded from the general regime;
" [(c) which debtors have sufficient connection to this State to be subject to its insolvency laws.]

"(1) Eligibility

"(a) An insolvency law should govern insolvency proceedings of all debtors engaged in commercial activities [including State-owned enterprises engaged in commercial activities].

"(b) Banks, insurance companies and other specified entities which are subject to special regulation and a specialized insolvency regime may be excluded from the application of the general insolvency law.

"(2) Jurisdiction

"(a) Insolvency proceedings may be commenced by or against a debtor if the debtor has its centre of main interests or its establishment in the enacting State.

"(b) In the absence of proof to the contrary, a legal person is presumed to have its centre of main interests in the State in which it has its registered office.

"(c) In the absence of proof to the contrary, a natural person is presumed to have its centre of main interests in the State in which it has its habitual residence."

248. It was suggested that in the section addressing jurisdiction, the words "by or against" the debtor should be replaced with "vis-à-vis" the debtor because the connecting factor was simply the debtor. The notion of the voluntary or involuntary nature of the application was addressed in the paragraphs on application and commencement of proceedings.

C. Application and commencement

249. The Working Group considered paragraphs on application and commencement of proceedings which had been revised on the basis of its earlier deliberations as follows:

"The purpose of provisions on application and commencement criteria is to:

"(a) facilitate easy access to the insolvency law by debtors, creditors and government agencies;

"(b) enable applications for insolvency proceedings to be made and dealt with in a speedy, efficient and inexpensive manner;

"(c) facilitate access to the insolvency procedures that are most relevant to the debtor's financial situation;

"(d) protect both debtors and creditors from possible wrongful use of the insolvency law and establish basic safeguards.

"(1) An application to commence insolvency proceedings shall be made to the court by:

"(a) a debtor which can show that it is or will be unable to pay its debts as and when they fall due [or that its liabilities exceed the value of its assets];

"(b) one or more creditors with claims against the debtor that are [mature and have not been paid by the debtor] or who can show that the debtor [is unable to pay its debts as and when they fall due or that its liabilities exceed the value of its assets];

"[(c) a prescribed government or non-government authority on the basis of […]].

"(2) An application for commencement of proceedings should establish that the debtor is insolvent and, in the case of an application to commence reorganization proceedings, should show that the debtor has a reasonable prospect of reorganization.

"(a) In the case of a voluntary application by the debtor the [application should function as automatic commencement of proceedings] [the court shall promptly determine whether the insolvency proceeding should be commenced].

"(b) In the case of an involuntary application,

"(i) notice shall promptly be given to the debtor,

"(ii) the debtor shall be allowed to respond to the application, and

"(iii) the court shall promptly determine whether the insolvency proceeding should be commenced.

"(3) The court may dismiss a proceedings [or convert it] if it is determined to be an abuse of the process.

"(4) In the case of a voluntary application by a debtor, notice of the commencement of the proceedings should be provided to creditors.

" (a) Notification of commencement of proceedings should be given to creditors individually, unless the court considers that, under the circumstances, some other form of notification would be more appropriate. [Notification should also be given to the known creditors that do not have addresses in this State. No letters rogatory or other, similar formality is required. *[Note to the Working Group: do the provisions of the Model Law need to be repeated here?]*

"(b) The notification to creditors should:

"(i) indicate any applicable time period for making a claim and specify the place at which it can be made;

"(ii) indicate whether secured creditors need to make a claim to the extent to which their claims are or are not covered by the value of the security; and

"(iii) contain any other information required to be included in such a notification to creditors pursuant to [*the law of the State and the orders of the court*].

250. Some concern was expressed in relation to the inclusion in paragraph (2) of the requirement to show that the debtor had a reasonable prospect of reorganization. It was suggested that paragraph (3) should include the possibility of sanctions where applications were made without good cause.

251. For lack of time the Working Group did not complete its consideration of the revised paragraphs on application and commencement.