United Nations A/CN.9/WG.V/WP.54

General Assembly

Distr.: Limited
22 May 2001

Original: English

United Nations Commission on International Trade Law
Working Group on Insolvency Law
Twenty-fourth session
New York, 23 July-3 August 2001

Draft legislative guide on insolvency law

Report of the Secretary-General

Contents

[Part Two of the draft legislative guide appears in document A/CN.9/WG.V/Wp.54/Add.1 and Part Three in document A/CN.9/WG.V/Wp.54/Add.2.]

V.01-84155 (E) 280501 290501

Background remarks

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. The proposal referred to recent regional and global financial crises and the work undertaken in international forums in response to those crises. Reports from those forums stressed the need to strengthen the international financial system in three areas - transparency; accountability; and management of international financial crises by domestic legal systems. According to those reports, strong insolvency and debtor-creditor regimes were an important means for preventing or limiting financial crises and for facilitating rapid and orderly workouts from excessive indebtedness. The proposal 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 to put insolvency law on its agenda.

2. The Commission expressed its appreciation for the proposal. It noted that different work projects had been undertaken by other international organizations such as the International Monetary Fund, the World Bank and the International Bar Association on the development of standards and principles for insolvency regimes. It noted that the broad objective of those organizations, while differing in scope and working methods as a consequence of their respective mandates and membership, was to modernize insolvency practices and laws. The initiatives taken in those organizations were proof of the necessity of assisting States to re-assess their insolvency laws and practices. Those various initiatives, however, were also in need of strengthened coordination, where appropriate, so as to avoid inefficient duplication of work and achieve consistent results.

3. Recognition was expressed in the Commission for the importance to all countries of strong insolvency regimes, as 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. 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.

4. To facilitate that further study, the Commission decided that an exploratory session of a working group should be convened to prepare a feasibility proposal for consideration by the Commission at its thirty-third session. That exploratory session of the Working Group on Insolvency Law was held at Vienna from 6 to 17 December 1999.

5. At its thirty-third session (2000) the Commission noted the recommendation that the Working Group had made in its report (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. 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). Accordingly, in order to obtain the views and benefit from the expertise of those organizations, the Secretariat was asked to organize a colloquium before the next session of the Working Group, in cooperation with INSOL and the IBA.[1]

6. That colloquium was organized with the co-sponsorship and organizational assistance of INSOL and in conjunction with the IBA at Vienna, 4-6 December 2000. The approximately 150 participants from 40 countries included lawyers, accountants, bankers, judges and insolvency practitioners, as well as representatives of Governments and international organizations such as the ADB, the European Bank for Reconstruction and Development (EBRD), the IBA, the IMF, INSOL and the World Bank. The speakers included insolvency officials, judges, practitioners and representatives of organizations who have had significant experience in insolvency law and law reform initiatives.

7. Broad support was expressed in favour of the Commission undertaking work on the key elements of an effective insolvency regime (see Report on UNCITRAL/INSOL/IBA Global Insolvency Colloquium, document A/CN.9/495, para. 34). The Colloquium strongly recommended that approximately 6 months be allowed for thorough preparation of drafts for consideration by the Working Group. It was noted also that the mandate given by the Commission to the Working Group referred to the work underway or already completed by other international organizations and required the Working Group to commence its work after receipt of the reports currently being prepared by other organizations, including the World Bank. The Colloquium heard that the World Bank report was expected to be finalised in early 2001.

8. In light of those factors, the meeting of the Working Group scheduled for 26 March to 6 April 2001 at New York was rescheduled for 23 July to 3 August 2001 at New York. Subject to approval by the Commission, a further Working Group meeting might take place from 3-14 December 2001 at Vienna.

9. This report sets forth the Introduction, Definitions and Part One of the draft legislative guide on insolvency law. Part Two *Core provision of an effective and efficient insolvency regime* appears in document A/CN.9/WG.V/WP.54/Add.1 and Part Three *Draft legislative provisions* appears in document A/CN.9/WG.V/WP.54/Add.2.

[1] Official Records of the General Assembly, Fifty-fifth Session, Supplement No. 17, A/55/17, para. 408.

Draft legislative guide on insolvency law

Introduction

1. Organization and scope of the Guide

10. The purpose of the present Guide is to assist in the development of efficient and effective legal frameworks for insolvency. The advice provided in the Guide aims at achieving a balance between, on the one hand, provisions necessary to encourage the early use of and access to an insolvency regime in order to maximise the utility of the tangible and intangible assets of an enterprise on a fair and balanced basis to the stakeholders and avoid the erosion of value through delay, and various public interest concerns, on the other.

11. The Guide is arranged in three Parts.[2] Part One establishes the key objectives of an efficient and effective insolvency regime. Part Two addresses the core provisions of an efficient and effective insolvency regime. Part two is arranged in two sections. The first section offers an analytical introduction to the issues raised by a particular subject area and sets forth policy considerations and options. The second section provides a summary of the different approaches that may be taken to the issues discussed in the first section [and includes recommended approaches]. Part Three sets forth legislative provisions implementing some of the approaches from Part Two. These provisions are intended to form the essential elements of an effective and efficient insolvency framework. The user is advised to read the legislative provisions together with the introductory notes, which provide background information to enhance the understanding of the legislative provisions.

12. The legislative provisions deal with matters that it is important to address in legislation specifically concerned with insolvency, be it liquidation or reorganization. They do not deal specifically with other areas of law, such as [foreign investment law, labour law and others…] that may impact upon insolvency law, but where relevant those other areas of law are identified and discussed. The successful implementation of an insolvency regime typically requires various measures beyond the establishment of an appropriate legislative framework, such as adequate administrative structures and practices, organizational capability, technical expertise and training of professionals. Although some of these matters may be mentioned in the analytical introduction, they are not addressed in the legislative provisions. *[References to material on these issues, such as that of the Asian Development Bank and the World Bank may be included here.]*

13. The Guide does not address questions of relevance to cross-border aspects of insolvency law, such as the treatment of foreign creditors. These matters are addressed in the UNCITRAL Model Law on Cross-Border Insolvency and it recommended that that text be considered in addition to this Guide. The Guide is not intended to modify or amend any provision of the Model Law in any way.

[2] Matters noted in the text between square brackets are intended only to assist the Working Group by raising issues for consideration and indicating alternative drafting. They would not appear in the final version of the Guide.

2. Terminology used in the Guide and role of definitions

14. The following definitions are only intended to provide orientation to the reader of the Guide. Many terms such as “secured creditor”, “liquidation” and “reorganization” may have fundamentally different meanings in different jurisdictions and the inclusion of a definition in the Guide may assist in ensuring that the concepts as included in the Guide are clear and widely understood. [When alternative definitions are proposed, they appear between square brackets. Possible additional conditions or wording is also included in square brackets.]

15. [Reference in the Guide to the “the court” might need to be further qualified. The draft provisions of the Guide assume that there is reliance on court supervision throughout the insolvency proceedings which might include the power to commence insolvency proceedings, to appoint the insolvency representative, to supervise its activities and to take decisions in the course of those proceedings. Although this reliance may be appropriate as a general principle, alternatives may be considered where, for example, the courts are unable to handle insolvency work or supervision by an administrative agency is preferred.]

3. Definitions

Avoidance action	action which allows transactions to be cancelled or otherwise rendered ineffective. Transactions that may be avoided include those (a) between a debtor and a creditor having the effect of creating a preference in favour of that creditor to the prejudice of the general body of creditors [other than in the normal course of trade], having taken place within [a specified period of time] before the commencement of the proceedings or (b) in which a debtor’s assets were transferred for unfair value or (c) in which a debtor’s assets were transferred in fraud of creditors
Centre of main interests	the place where the debtor conducts the administration of its interests on a regular basis, as such ascertainable by third parties
Claim	enforceable right to money or property
Collateral	property subject to a security interest to the benefit of one or more creditors, who are entitled to sell it in the event of default (see secured claim)
Commencement of proceedings	[date as of which the effects of insolvency are applicable] or [date as of which the judicial decision commencing insolvency proceedings becomes effective, whether it is a final decision or not]

Composition	[within the context of reorganization,] agreement between the debtor and the [majority of] creditors whereby the creditors accept reduction or postponement of debts or the redefinition of payment terms
Creditors' committee	representative body appointed by [the court] [the insolvency representative] [creditors as a whole] qualified to act on behalf and in the interests of the creditors and possessing consultative powers [and supervising the insolvency representative]
Debtor	person or entity engaged in a business enterprise and which meets the criteria for, and is subject to, insolvency proceedings, with the exception of entities subject to a special insolvency regime [including banking and financial institutions, insurance companies and [*other*]]
Establishment	any place of operations where the debtor carries out a non-transitory economic activity with human means and goods or services
Initiation of proceedings	the making of an application for commencement of insolvency proceedings by: - the debtor - one or more creditors - the general public attorney - the insolvency court of its own motion
Insolvency	[when the debtor is [likely to become] unable or is no longer able to pay its debts and other liabilities as they fall due] or [when the value of debts and liabilities of the debtor exceeds the value of assets] or [when the debtor generally ceases to pay or suspends payment of its debts and other liabilities as they fall due, the cash assets being insufficient] or [when the debtor ceases to pay important and sensitive debts, such as rent, wages and social security payments]
Insolvency estate	[goods and rights pertaining to the debtor as of and after the commencement of the proceedings which can be evaluated in money [and all of which form the debtor's property and constitute assets available for payment of creditors' claims] or

	[goods and rights pertaining to the debtor which can be evaluated in money [and are available for creditors as their security]
Insolvency proceedings	collective proceedings which involve the [partial or total] divestment of the debtor and the appointment of an insolvency representative [for the purpose of either liquidation or reorganization of the business] [including both liquidation and reorganization proceedings]
Insolvency representative	[person [or entity] appointed by the court which is in charge of administering the debtor's estate [and assisting and watching over the management of the business] with a view to either liquidation or reorganization of the business; or person [or entity] appointed by the insolvency court to whom the powers of the debtor['s management] to administer, sell or dispose of [assets included in] the insolvency estate are transferred as of the commencement of the proceeding, acting under the supervision of the court. Such powers include without limitation the following: determining or assisting in determination of creditors' claims; realizing the [assets pertaining to the] insolvency estate; making distributions of proceeds among to creditors; taking avoidance actions
Insolvency decision	decision of the court to commence an insolvency proceeding [and to appoint an insolvency representative]
Involuntary proceedings	insolvency proceedings initiated by creditors or by the general public attorney's office or [*other*]
Liquidation	process whereby a debtor has its assets assembled, disposed of and distributed to the benefit of [the insolvency estate and] the creditors, including shareholders [followed by the dissolution of the legal entity], either by way of a piecemeal sale or a sale of all or most of the debtor's assets in productive operating units or as a going concern
Netting	In one form it can consist of set-off (see 'set-off') of non-monetary fungibles (such as securities or commodities deliverable on the same day, known as settlement netting) and in its more important form it consists of a cancellation by a counterparty of open contracts with the insolvent, followed by a set-off of losses and gains either way (close-out netting)

Observation period	[within the context of a unitary (see Part Two.I.B) insolvency proceeding], the possibility or otherwise of successful reorganization must be established
Pari passu	principle according to which creditors of the same class are treated equally [and are paid proportionately out of the assets of the estate]
Pending contracts	contracts outstanding [and not fully performed] as of the commencement of the proceeding
Post-commencement creditor	creditor whose claim has arisen after commencement of the insolvency proceedings
Preferential claims	claims which are to be paid from assets available to pay unsecured debt before payment of general creditors
Preliminary insolvency representative	person or entity appointed by the insolvency court in case of a serious crisis of the debtor which prevents the normal operation of its business, required to ensure temporarily further carrying on the business in connection with suspension of the debtor or of the debtor's management (possibly in connection with reorganization)
Reorganization	process of restructuring an insolvent enterprise in order to [rescue the debtor and] restore the financial well being and the viability of the business, by way of various means possibly including debt forgiveness, debt rescheduling, debt-equity conversions [and sale of the business as a going concern]
Reorganization plan	plan to reorganize the business [and redress the debtor] submitted by [the debtor][the creditors][the insolvency representative] and approved by the court, addressing issues such as timing of the process, commitments to be undertaken, terms of payment and securities to be offered to creditors, avoidance actions to be filed and treatment of pending contracts including employment contracts
Secured claim	claim assisted by a security taken as a guarantee for a debt enforceable in case of the debtor's default when the debt falls due

Secured creditor	creditor holding either a security covering all or part of the debtor's assets or a security over a specific asset entitling the creditor to preference ahead of other creditors with respect to the encumbered assets
Secured debt	[aggregate amount of secured claims] or [claims pertaining to secured creditors]
Set-off	where a claim for a sum of money owed to a person is "set-off" (balanced) against a claim by the other party for a sum of money owed by that first person. May operate as a defence in whole or part to a claim for a sum of money
Stay of proceedings	suspension of the power of the creditors to commence or continue judicial, administrative or other individual actions for enforcement and recovery of their claims, or for obtaining possession of property pertaining to the insolvency estate, or for creating, perfecting or enforcing any security over property pertaining to the insolvency estate
Unsecured debt	aggregate amount of claims not supported by security
Voluntary proceedings	insolvency proceedings initiated by the debtor

Part One

Key objectives of an effective and efficient insolvency regime

1. Maximize value of assets

16. Insolvency law should provide for the possibility of reorganization of the debtor as an alternative to liquidation, where creditors would not involuntarily receive less than in liquidation and the value of the debtor to society and to creditors may be maximised by allowing it to continue. The maximum value for creditors can often be obtained through reorganization rather than liquidation. A broadly phrased "arrangement" or "method" aimed at maximising the return and minimizing the effects of insolvency would include a range of possible insolvency techniques and avoid implied preference for one technique over the other.

2. Strike a balance between liquidation and reorganization

17. An insolvency regime needs to balance the advantages of near-term debt collection through liquidation (often the preference of secured creditors) against maintaining the debtor as a viable business through reorganization (often the preference of unsecured creditors). Goals other than maximum recovery for creditors, such as encouraging the development of an entrepreneurial class and protecting employment are relevant to achievement of this balance.

3. Equitable treatment

18. An insolvency regime should treat similarly-situated creditors, including both foreign and domestic creditors, equitably. Equitable treatment recognizes that all creditors do not need to be treated equally, but in a manner that reflects the different bargains that they have struck with the debtor, as well as the prerogatives pertaining to holders of claims or interests that arise by operation of law. The insolvency regime should address problems of fraud and favouritism that may arise in cases of financial distress, by providing that acts detrimental to equitable treatment of creditors can be avoided.

4. Provide for timely, efficient and impartial commencement of proceedings and for resolution of insolvency

19. Insolvency should be addressed and resolved in an orderly, quick and efficient manner, with a view to avoiding undue disruption to the business and the activities of the debtor and to minimizing the cost of the proceedings. To facilitate this, it may be useful to establish time limits in the law for the completion of certain matters (such as providing a deadline for preparing the reorganization plan or in respect of the duration of the stay upon creditors) and for the proceedings as a whole. It might also be useful to allocate responsibility for the process to the entity administering the debtor's assets, as well as to establish specialized courts or administrative organs or bodies to supervise and direct the process. [Sanctions for failure to commence at an early stage might also be provided].

5. Prevent premature dismemberment of the debtor's assets by creditors

20. Creditors should be restrained from prematurely dismembering the debtor's assets by the imposition of a stay. Such stay would be aimed at enabling a proper

examination of the debtor's situation and would facilitate both maximization of the value of the estate and equitable treatment of creditors.

6. Provide for a procedure that is predictable and transparent

21. Relevant risk allocation rules should be clearly specified in the law and consistently applied to ensure that there is confidence in the process and that all participants are able to adopt appropriate measures to manage risk. Transparency is closely related to the objective of predictability and requires that participants in the process be given sufficient information. In order to ensure that adequate information is available in respect of the debtor's situation, incentives encouraging the debtor to reveal its positions or sanctions for failure to do so could be provided. In addition, where the law provides for the exercise of discretion, it should also provide adequate guidance as to how that should be exercised.

7. Establish a framework for cross-border insolvency

22. To promote co-ordination among jurisdictions, insolvency laws should provide rules on cross-border insolvencies with recognition of foreign proceedings, possibly by way of adoption of the UNCITRAL Model Law on Cross-Border Insolvency.