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Insolvency Law: possible future work

Note by the Secretariat

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III. Future Work

A. Introduction

1. At its thirty-seventh session in 2009, the Working Group had a preliminary exchange of views on possible topics for future work. The Report of that session (A/CN.9/686, paras. 127-130) notes that the Working Group had before it a proposal by the Union Internationale des Avocats (UIA) on a possible international convention in the field of international insolvency law, which might cover the following issues:

(a) Granting of access to courts to foreign insolvency representatives;

(b) Recognition of foreign insolvency proceedings (with the effect of granting the foreign proceeding the rights of a national proceeding or triggering a secondary proceeding); and

(c) Cooperation and communication between insolvency representatives and courts.

2. If agreement on those issues seemed possible, the proposal suggested the international convention might also contain provisions on:

(a) Direct competence ("convention double");

(b) Applicable law ("convention triple", could be part of a separate protocol).

3. Other topics proposed for consideration included: liability of directors and officers of enterprises in insolvency or in proximity to insolvency; insolvency of banks and financial institutions; the concept of centre of main interests (COMI) of an enterprise and the factors relevant to its determination, as well as issues of jurisdiction and recognition; the development of a Model Law based on the Legislative Guide or on some aspects of the Legislative Guide, including the recommendations currently being finalized on international aspects of the treatment of enterprise groups; review of the enactment of the Model Law and promotion of its wider adoption; sovereign insolvency; and the insolvency of public or State-owned enterprises.

4. Preliminary support was expressed in favour of various proposals, noting that more detailed information would be required in order to facilitate discussion, possibly at the next session of the Working Group. It was suggested that the feasibility of some proposals would depend upon the scope of the work proposed and, in the case of the proposal for an international convention, upon support from Governments and cooperation with other international organizations with competence in related areas. Support was expressed in favour of the goal of developing an international convention, but there were reservations with respect to the feasibility of reaching agreement, particularly in view of the difficulties encountered in the past in the area of international insolvency law. With respect to other proposals, in particular the insolvency of banks and financial institutions, more information was required with respect to work currently being undertaken by other international organizations in order to consider whether there was any scope for work by UNCITRAL.

5. The purpose of this note is to provide background information with respect to some of the topics noted above to assist the Working Group in its deliberations at its thirty-eighth session. The Working Group may wish to note that much of the information is very preliminary in nature and is intended to provide only a brief introduction, with a particular focus on work being undertaken by other organizations or on reports identifying particular needs. In considering possible topics for future work and the desirability of making a recommendation to the Commission in that regard, the Working Group may also wish to consider the need for further information.

B. Background information on topics proposed for possible future work

1. Liability of directors and officers of enterprises in insolvency or in proximity to insolvency

6. At its thirty-eighth session in 2005, the Commission considered a proposal by the International Insolvency Institute (III) on directors' and officers' responsibilities and liabilities in insolvency and pre-insolvency cases (A/CN.9/582/Add.6). That document will be made available for the information of the Working Group at its thirty-eighth session.

7. Having considered the proposal, the Commission concluded[1] that "while the topic was an important one, it might involve questions of criminal law that would be outside the mandate of the Commission or questions for which it might be difficult to find harmonized solutions. For those reasons, that topic might not be as susceptible as other topics to future work at that time."

8. If the Working Group is of the view that the topic merits further consideration at this time, it may wish to consider the focus and substance of the proposal in the light of the conclusions reached by the Commission.

2. Insolvency of banks and financial institutions

9. The Working Group may wish to note that for some years, work has been ongoing in several international organizations with respect to various aspects of the insolvency of banks and financial institutions and more particularly as a result of the global financial crisis. The Working Group may wish to note the following summary of the recent work of several organizations on this issue.

(a) International Monetary Fund and World Bank

10. In April, 2009, for example, the International Monetary Fund and the World Bank issued a study entitled "An Overview of the Legal, Institutional, and Regulatory Framework for Bank Insolvency." The study provides an overview of the legal, institutional, and regulatory framework that countries should put in place to address cases of bank insolvency. It is primarily intended to inform the work of the staff of the International Monetary Fund (IMF) and World Bank, and to provide

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[1] *Official Records of the General Assembly, Sixtieth Session, Supplement No. 17* (A/60/17), paragraph 209.

guidance to their member countries. The study deals exclusively with the legal, institutional, and regulatory frameworks for insolvent banks — that is, deposit-taking institutions; other types of financial institutions are not covered. Moreover, the focus is purely domestic; issues of cross-border bank insolvency are not addressed.

11. The study is part of a broader work agenda of IMF and World Bank staff on issues of financial sector stability. Several projects are currently underway in the IMF that will address issues that are not covered by the present study, including an examination of the legal and regulatory questions that arise in the insolvency of non-bank financial institutions, the treatment of complex financial instruments in insolvency proceedings, and the legal framework for information sharing among domestic financial sector supervisors, and supervisory oversight and intervention in a cross-border context.

12. The report acknowledges the important work being done by other international bodies on issues of financial sector stability — for example, the study currently underway in the Basel Committee on Banking Supervision on issues of cross-border bank resolution.

(b) Basel Committee on Banking Supervision

13. In September 2009, the Basel Committee on Banking Supervision issued a consultative document entitled "Report and Recommendations of the Cross-border Bank Resolution Group", outlining a set of ten recommendations for implementation by national authorities to improve cross-border crisis management and resolutions. The consultation paper notes the significant connection between banking, insolvency and company law and, in the cross-border context, raises many of the issues discussed by Working Group V in its deliberations on enterprise groups. In particular, the paper suggests that:

> "National authorities and policymakers should examine whether the recommendations which UNCITRAL is developing for judicial bankruptcy proceedings governing groups of enterprises could inform the work underway to improve the coordination of resolution proceedings of financial groups and conglomerates."[2]

(c) European Union

14. The European Union has issued a Communication on "A Bank Resolution Framework for the EU", which presents an overview of the problems, the areas under examination related to early intervention measures and bank resolution and seeks views on the implementation of an EU framework for crisis resolution in the banking sector. It proposes policy objectives and an overall approach, but no specific detailed policy solutions at this stage. A broad range of issues is considered, from "early intervention", when early remedial action by banking supervisors aims to correct irregularities at banks and help them return to normal course of business, to bank resolution measures entailing the reorganization of ailing banks with a view to safeguarding financial stability, the continuity of banking services and the

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[2] Basel Committee on Banking Supervision, Report and Recommendations of the Cross-border Bank Resolution Group, para. 72, available from http://www.asbaweb.org/Consulta-Reporte.pdf.

revitalization of the bank and to insolvency frameworks under which failed banks are wound up. The Communication notes UNCITRAL's work on enterprise groups, specifically those aspects dealing with facilitating the continuous operation of the business under reorganization or liquidation by securing continuous access to funds.

15. The Communication goes on to note the potential desirability of facilitating a more integrated treatment of enterprise groups, particularly banking groups, in insolvency:

> "This might involve — in clearly specified circumstances — treating the group as a single enterprise in order to overcome the perceived inefficiency and unfairness of the traditional single entity approach. While techniques to achieve this are available under some national law, their application is necessarily restricted to entities within the same jurisdiction, and subject to the same insolvency regime. If similar measures were to be developed for use in insolvency proceedings for cross-border banking groups, the fact of different insolvency regimes — with different substantive rules on, for example, priority and avoidance powers — would need to be addressed."[3]

3. The concept of centre of main interests (COMI) of an enterprise and the factors relevant to its determination, as well as issues of jurisdiction and recognition

16. A proposal has been received from the delegation of the United States of America, which is set forth in Add.1 to this Note. A background paper supporting that proposal is set forth in Add.2.

4. The development of a Model Law based on the Legislative Guide or on some aspects of the Legislative Guide, including on the international treatment of enterprise groups

17. The proposal received from the delegation of the United States of America, which is set forth in Add.1 to this Note, touches also upon this topic.

18. The Working Group may recall that, in its deliberations on international aspects of enterprise groups, some of the issues considered included how the solutions provided by the UNCITRAL Model Law on Cross-Border Insolvency (the Model Law) might apply to enterprise groups, particularly with respect to facilitating cross-border cooperation and resolving the question of the centre of main interests of an enterprise group (A/CN.9/647, paras. 85-96; A/CN.9/666, paras. 24-39; A/CN.9/671, paras. 16-55).

19. The Working Group may also recall it acknowledged, at its thirty-sixth session in 2009, that, "although the form of a Model Law might be desirable, it might not be realistic to pursue that type of text at this stage in view of the time that might be required for its negotiation, the current need for the provisions on enterprise groups in light of the global financial crisis and the question of whether there was the support necessary for its negotiation (A/CN.9/671, para. 55)." For those reasons,

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[3] Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee, the European Court of Justice and the European Central Bank: An EU Framework for Cross-Border Crisis Management in the Banking Sector, COM (2009) 561 final, Brussels, 20/10/2009, available from http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2009:0561:FIN:EN:PDF, pp. 15-16.

and because the content of the draft recommendations being considered addressed the content of domestic law, the Working Group agreed that the recommendations on international treatment of enterprise groups in insolvency should be added to part three of the Legislative Guide.

20. The Working Group may also wish to note paragraphs 5 and 6 of document A/CN.9/WG.V/WP.92/Add.1, which recall the discussion on centre of main interests in the context of enterprise groups and the challenge of reaching broad international agreement on that issue in order to achieve a consistently, widely applied and, possibly, binding solution that would deliver certainty and predictability to the cross-border insolvency of enterprise groups. It might also wish to recall that, at its thirty-seventh session in 2009, the issues of access to courts and recognition of proceedings were raised as possible pre-conditions to cross-border cooperation. A draft recommendation to the effect that insolvency laws should address those issues was added to the recommendations that will form part three of the Legislative Guide.

5. Review of the enactment of the Model Law and promotion of its wider adoption

21. The report of the thirtieth session of the Commission in 1997, on the occasion of adoption of the UNCITRAL Model Law on Cross-Border Insolvency, notes:[4]

> "223. The Commission heard the proposal that, having completed the work on model legislation, it should prepare model provisions for an international treaty, bilateral or multilateral, on judicial cooperation and assistance in cross-border insolvency or a full-fledged treaty on those matters. It was recalled that such work had been mentioned as a possibility at the twentieth session of the Working Group on Insolvency Law (A/CN.9/433, paras. 16-20). In addition to that proposal, various other topics were mentioned with respect to which it might be worthwhile to explore the desirability and feasibility of work at the international level; those were: legislative treatment of cross-border insolvency in the banking and financial services sector, preparation of model agreements or practices for cross-border cooperation in reorganizations of insolvent enterprises, conflict-of-laws solutions in cross-border insolvency cases, and the effects of insolvency proceedings on arbitration agreements and arbitral proceedings.
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> "224. After discussion, the Commission adopted the view that it would be preferable, before deciding whether to undertake work towards a treaty or to deal with any other topic mentioned, to evaluate the impact of, and the experience with, the Model Law and to await the results of similar work in other international forums, such as the European Union, and possibly the Organization of American States. In the meantime, the Secretariat was requested to monitor the developments in the field and to formulate suggestions for a future session of the Commission as to the desirability and feasibility of any such work.
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> "225. During the final considerations of the Model Law, it was proposed, and the Commission agreed with the proposal, that the Secretariat should collect information on the enactment of the Model Law in various States, and,

[4] *Official Records of the General Assembly, Fifty-second Session, Supplement No. 17* (A/52/17).

> in cooperation with relevant organizations that had the expertise in the area, to monitor the developing practices, experience and issues that would emerge from the use of national laws based on the Model Law. The holding of judicial colloquia, which had been convened during the preparatory work towards the Model Law, was mentioned as one possible method for such evaluation work."

22. In 2005, the Secretariat prepared a short note covering, inter alia, developments with adoption of the Model Law, which included a short summary of the changes that had been adopted by the eight States enacting legislation based on the Model Law as at 15 April 2005 (A/CN.9/580).

23. The Working Group may wish to note the collection of case law on enactments of the Model Law (CLOUT issues 72, 73, 76 and 92 with further issues due for publication in 2010).[5]

24. The Working Group may also wish to note that the 8th Multinational Judicial Colloquium was held in Vancouver, Canada in May 2009. The 9th Colloquium is currently planned to be held in Singapore in 2011. A regular feature of those colloquia has been a review of developments with respect to adoption and use of the Model Law.

25. The Working Group may wish to consider what further information might be collected and made available with respect to enactment of the Model Law.

6. Sovereign insolvency

26. In the early 2000s, there was considerable interest in the topic of sovereign insolvency and the need to develop mechanisms to address the issues raised by it. Various mechanisms were proposed to address those issues, including by the IMF. Following the financial crisis of 2008, the need for such a mechanism was further discussed in various forums, including the United Nations. In considering this topic and the potential for future work by UNCITRAL, the Working Group may wish to note the following information, which provides a very brief indication of the current status of the development of such mechanisms.

27. The Report of the Commission of Experts of the President of the United Nations General Assembly on Reforms of the International Monetary and Financial System of 21 September, 2009[6] considers the mechanisms currently available to address sovereign debt default and restructuring and notes, inter alia, that:

> 63. The existing "system" (or really "non-system") arose as piecemeal and mostly ad hoc intergovernmental responses to sovereign debt crises as they occurred over the past half-century or so. The fact that the solutions the current system provides take time to be adopted and provide inadequate relief implies that the system for addressing sovereign debtors is clearly inferior to that provided in many countries for corporations and sub-sovereign public entities by national bankruptcy regimes."

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[5] Available from http://www.uncitral.org/uncitral/en/case_law/abstracts.html.

[6] Available from http://www.un.org/esa/desa/desalert/2009/Nov/UNFinalReport.pdf, paras. 59-84.

28. In preliminary recommendations,[7] the Commission recommended:

> "71. There is an urgent need for renewed commitment to develop an equitable and generally acceptable Sovereign Debt Restructuring Mechanism, as well as an improved framework for handling cross-border bankruptcies. One way by which this might be done is through the creation of an independent structure, such as an International Bankruptcy Court. The United Nations Commission on International Trade Law provides a model that could be extended to the harmonization of national legislation on cross-border disputes dealing with trade in financial services."

29. A 2009 Report by the Secretary-General "Towards a durable solution to the debt problems of developing countries,"[8] concludes:

> "63. A continued deterioration of economic conditions may push some countries with access to international capital markets towards sovereign default. It is thus lamentable that the design of a mechanism aimed at facilitating the resolution of sovereign insolvency has been marginalized in the international discussion. The outcome document of the Conference on the World Financial and Economic Crisis underlines the need of a more structured framework for international cooperation in this area (A/CONF.214/3, para. 34). In this context, it would also be desirable for the international community to discuss and promote responsible lending and borrowing."

7. The insolvency of public or State-owned enterprises

30. With respect to this topic, the Working Group may wish to note the extent to which it was previously considered in formulating the Legislative Guide.

31. In December 2000, UNCITRAL held an international colloquium to discuss the development of its future work on insolvency law. Amongst the issues discussed was the scope of that work, such as whether an insolvency law should include, for example, banks, insurance companies and state-owned enterprises (SOE). It was suggested that if SOEs were to be included in the scope of an insolvency framework, there might be important social considerations, including cultural sensitivities, issues of compatibility with the social fabric and the purposes and goals of insolvency law as they related to these types of debtor in different societies, that would need to be reviewed for their impact on eligibility criteria.

32. When the Legislative Guide was formulated, the view taken of SOEs was that the insolvency law could apply to such enterprises where they were engaged in economic activity and competed in the market place as distinct economic or business operations and had the same commercial and economic interests as privately-owned businesses. The Legislative Guide notes the advantages of subjecting such enterprises to the discipline of the insolvency law, but also the need to minimize conflicts of interest with respect to the role played by the State in those

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[7] Transmitted to the General Assembly by the President of the General Assembly on 19 March 2009, available from http://www.un.org/ga/president/63/letters/CommisionExperts200309.pdf.

[8] A/64/167, 24 July 2009, submitted to the General Assembly pursuant to resolution A/63/206: External debt and development: towards a durable solution to the debt problems of developing countries.

enterprises. It also notes that there may be a need for exceptions to a general policy of inclusion in a general insolvency law, such as where the treatment of SOEs is part of a large-scale privatization program, but does not consider those exceptions in any detail (Legislative Guide, part two, chap. I, paras. 8-10 and recommendation 8).

33. The Working Group might also wish to note that the World Bank Principles for Effective Insolvency and Creditor Rights Systems echo the approach of the Legislative Guide, providing, in principle C.3 that:

> "The insolvency proceeding should apply to all enterprises or corporate entities, including state-owned enterprises. Exceptions should be limited, clearly defined, and should be dealt with through a separate law or through special provisions in the insolvency law."