

Revised Draft

**CREDITOR RIGHTS AND INSOLVENCY
STANDARD**

based on

THE WORLD BANK

**PRINCIPLES FOR
EFFECTIVE INSOLVENCY AND CREDITOR/DEBTOR REGIMES^{*}**

and

UNCITRAL

LEGISLATIVE GUIDE ON INSOLVENCY LAW

^{*} Revised Draft [January 2011]

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INTRODUCTION

Effective and efficient insolvency and creditor rights systems are widely recognized as important elements of financial system stability. These systems help to ensure efficient access to credit and allocation of resources, enhancing productivity and growth. They also enable commercial stakeholders to better manage financial risk and other difficulties in the enterprise sectors in a timely way, so as to minimize systemic risk, particularly in the banking system.

In the context of the joint World Bank (Bank) and International Monetary Fund (Fund) initiative on standards and codes, insolvency and creditor rights constitute one of the 12 areas that have been identified as useful for the operational work of the Bank and the Fund, and for which standard assessments are to be undertaken.¹ Work towards defining an international standard on insolvency and creditor rights systems has been undertaken on two complementary fronts, led by the Bank and the United Nations Commission on International Trade Law (UNCITRAL).

The Bank-Fund initiative on standards and codes was developed in the wake of the financial crises of the late 1990s as part of a series of measures to strengthen the international financial architecture. The international financial community considered that the implementation of internationally recognized standards and codes would provide a framework to strengthen domestic institutions, identify potential vulnerabilities, and improve transparency. The Reports on the Observance of Standards and Codes ("ROSC") are designed to assess a country's institutional practices against an internationally recognized standard and, if needed, provide recommendations for improvement. The process of participation and the production of the report are intended to help spur reform and foster strengthened economic institutions in member countries.

In 1999, the Bank's initiative to develop benchmarking principles for core commercial law systems was launched, leading to the development of the *Principles and Guidelines for Effective Insolvency and Creditor Rights Systems* ("the *Principles*"). The *Principles* are designed as a broad-spectrum assessment tool to assist countries in their efforts to evaluate and improve the core aspects of their commercial law systems that are fundamental to a sound investment climate and commerce, including credit access and protection mechanisms, risk management and restructuring practices and procedures, formal commercial insolvency procedures, and related institutional and regulatory frameworks. The *Principles* were elaborated in collaboration with partner organizations and experts serving on the Bank's *Task Force* and working groups. Advisory partners included: African Development Bank, Asian Development Bank, European Bank for Reconstruction and Development, Inter-American Development Bank, International Finance Corporation, International Monetary Fund, Organization for Economic Cooperation and Development, UNCITRAL, INSOL International, and the International Bar Association (Committee J). The *Task Force* and working groups comprised more than 70 international experts. The *Principles* were vetted in a series of regional roundtables involving more than 700 participants from 75 countries (mostly middle-income and developing nations), involving high-level officials and designated experts from the private sector. The *Principles* were also posted on the Bank's website for international comment and discussed and approved by the Bank's Executive Directors in 2001 for use in a series of pilot country assessments under the ROSC program, subject to a review and updating of the *Principles* based on that experience.² In 2003, the Bank began a review of the ROSC experience on insolvency and creditor rights systems, and in 2005 the Bank concluded a revision of the *Principles*, which both took stock of the lessons learned from that experience and reflected feedback from the international community in connection with the Global Forum on Insolvency Risk Management, the Forum on Asian Insolvency Reform, the Forum on Insolvency in Latin America, and the Global Judges Forum. The revision was also based on the Bank's collaboration with its original partners, the European Commission, Group of Twenty, Asia-Pacific Economic Cooperation, International Association of Insolvency Regulators, and others.

¹ These twelve areas are grouped into three categories: transparency (data dissemination, fiscal, and monetary and financial policy), financial stability (banking supervision, insurance supervision, securities regulation, payments systems, anti-money-laundering/combating the financing of terrorism), and market integrity (accounting, auditing, corporate governance, insolvency and creditor rights). See "Summing Up by the Acting Chairman--Assessing the Implementation of Standards—A review of Experience and Next Steps," SUR/01/13; "Summing Up by the Acting Chair—Anti-Money Laundering and Combating the Financing of Terrorism—Proposals to Assess a Global Standard and to Prepare ROSCs," BUFF/02/122; and "Assessing the Implementation of Standards: A Review of Experience and Next Steps" (SecM2001-0032)

² World Bank 2001 (SecM2001-0192). Subsequently, the *Principles* were distributed to the Development Committee, which also acknowledged its support of the Bank's work in this area. Development Committee 2001 (DC/2001-0008/1).

World Bank Revised Principles for Effective Creditor Rights and Insolvency Regimes
UNCITRAL Legislative Guide on Insolvency Law

In 1999, UNCITRAL approved a proposal to develop its *Legislative Guide on Insolvency Law* (“*Legislative Guide*”) to encourage the adoption of effective national corporate insolvency regimes. A total of 87 states, 14 intergovernmental organizations, and 13 nongovernmental organizations participated in the inter-governmental working group tasked with developing the *Legislative Guide*. Work began in 2001, following an international colloquium with broad-based participation that discussed and recommended the form and content of the guide. The preparation was completed in 2004, and the *Legislative Guide* was adopted by consensus on June 25, 2004, during the 37th session of the Commission.

Recognizing the importance to all countries of strong, effective, and efficient insolvency regimes as a means of encouraging economic development and investment, the *Legislative Guide* was endorsed by the United Nations General Assembly on December 2, 2004. In its formal resolution, the General Assembly recommended “that all States give due consideration to the *Legislative Guide* when assessing the economic efficiency of their insolvency regimes and when revising or adopting legislation relevant to insolvency”.³ The *Legislative Guide* discusses issues central to the design of an effective and efficient insolvency law, based on policies and practices recognized in many legal systems, and contains detailed legislative *Recommendations* that incorporate flexibility, as appropriate, to accommodate different policy choices and contexts⁴.

While the Bank’s *Principles* and the UNCITRAL *Legislative Guide* have been devised according to their respective governance processes and structures, the Bank and UNCITRAL staff and experts have collaborated to ensure consistency in these complementary products.

The *Principles* cover a wider range of commercial law systems, including institutional and regulatory aspects of those systems, and elaborates fundamental principles intended to have flexible application to diverse country systems. The text of the *Principles* is available at <http://www.worldbank.org/gild>. The *Legislative Guide* focuses more deeply on the key elements of an effective insolvency law, and substantiates, with extensive discussion of various options and approaches, a detailed series of legislative *Recommendations* that provide specific guidance on the content of the insolvency law. The text of the *Legislative Guide* is available at http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency/2004Guide.html.

The complementary perspectives of the *Principles* and the *Legislative Guide* serve as important reference points for countries to evaluate and strengthen their insolvency and creditor rights systems in line with generally recognized standards of good practice. Given the complementarity of the documents and the international consensus on best practices reflected in the Bank’s *Principles* and in the *Recommendations* in the *Legislative Guide*, the staffs of the Bank and the Fund recommend that their respective Executive Boards recognize the *Principles* and the *Recommendations* as constituting the unified standard for insolvency and creditor rights systems for the purpose of the Bank/Fund initiative on standards and codes. Insolvency and Creditor Rights ROSC assessments will be conducted on the basis of this unified standard on insolvency and creditor rights systems.

The Bank staff and experts, in collaboration with the Fund and UNCITRAL staff and experts, have prepared the unified Standard for Insolvency and Creditors Rights Systems, which integrates the *Principles* and the *Recommendations* in a coordinated fashion. The ROSC Assessment Methodology (“ICR ROSC Methodology”) developed by the Bank staff and experts, in collaboration with the Fund and UNCITRAL staff and experts, is based on this Standard, in accordance with the objectives and within the parameters of the joint Bank/Fund initiative on standards and codes.

³ United Nations General Assembly, Resolution 59/40.

⁴ In addition to the *Legislative Guide*, UNCITRAL is currently working on its *Legislative Guide on Secured Transactions* (“*Secured Transactions Guide*”) addressing security interests in movable property, including inventory, equipment, receivables, and other types of assets. The policies and legislative recommendations of the draft *Secured Transactions Guide* have been approved by UNCITRAL in 2007, with a view to completion of the guide (including its commentary) in 2009. The *Secured Transactions Guide* will recommend a modern legal framework for the development of a comprehensive secured transactions regime that rises above differences among legal regimes and that could facilitate low-cost secured financing.

A. CREDITOR RIGHTS**1. KEY ELEMENTS****World Bank Principle****Key Elements [A1]**

A modern credit-based economy should facilitate broad access to credit at affordable rates through the widest possible range of credit products (secured and unsecured) inspired by a complete, integrated, and harmonized commercial law system designed to promote:

- Reliable and affordable means for protecting credit and minimizing the risks of nonperformance and default;
- Reliable procedures that enable credit providers and investors to more effectively assess, manage, and resolve default risks and to promptly respond to a state of financial distress of an enterprise borrower;
- Affordable, transparent, and reasonably predictable mechanisms to enforce unsecured and secured credit claims by means of individual action (e.g., enforcement and execution) or through collective action and proceedings (e.g., insolvency);
- A unified policy vision governing credit access, credit protection, credit risk management and recovery, and insolvency through laws and regulations that are compatible both procedurally and substantively.

2. SECURITY (IMMOVABLE PROPERTY)**World Bank Principle****Security (Immovable Property) [A2]**

One of the pillars of a modern credit economy is the ability to own and freely transfer ownership interests in land and land-use rights, and to grant a security interest (such as a mortgage or charge) to credit providers with respect to such interests and rights as a means of gaining access to credit at more affordable prices. The typical hallmarks of a modern mortgage system include the following features:

- Clearly defined rules and procedures for granting, by agreement or operation of law, security interests (mortgages, charges, etc.) in all types of interests in immovable assets;
- Security interests related to any or all of a debtor's obligations to a creditor, present or future, and between all types of persons;
- Clear rules of ownership and priority governing competing claims or interests in the same assets, eliminating or reducing priorities over security interests as much as possible;
- Methods of notice, including a system of registry, which will sufficiently publicize the existence of security interests to creditors, purchasers, and the public generally at the lowest possible cost.

3. SECURITY (MOVABLE PROPERTY)**World Bank Principle****Security (Movable Property) [A3]**

A modern credit economy should broadly support all manner of modern forms of lending and credit

transactions and structures, with respect to utilizing movable assets as a means of providing credit protection to reduce the costs of credit. A mature secured transactions system enables parties to grant a security interest in movable property, with primary features that include:

- Clearly defined rules and procedures to create, recognize, and enforce security interests over movable assets, arising by agreement or operation of law;
- Allowance of security interests in all types of movable assets, whether tangible or intangible (e.g., equipment, inventory, bank accounts, securities, accounts receivables, goods in transit; intellectual property and its proceeds, offspring, and mutations), including and with respect to present, after-acquired, or future assets (including goods to be manufactured or acquired), wherever located and on a global basis, and based on both possessory and non-possessory interests;
- Security interests related to any or all of a debtor's obligations to a creditor, present or future, and between all types of persons;
- Methods of notice (including a system of registration) that will sufficiently publicize the existence of security interests to creditors, purchasers, and the public generally at the lowest possible cost; and
- Clear rules of priority governing competing claims or interests in the same assets, eliminating or reducing priorities over security interests as much as possible.

4. REGISTRY SYSTEMS

World Bank Principle

Registry Systems [A4]

There should be an efficient, transparent, and cost-effective registration system with regard to property rights and security interests in the borrower's immovable assets. There should be an efficient, transparent and cost-effective means of providing notice of the possible existence of security interests in regard to the borrower's movable assets as well, with registration in most cases being the principal and strongly preferred method (with some exceptions). The registration system should be reasonably integrated, easily accessible, and inexpensive with respect to recording requirements and searches of the registry, and it should be secure.

A4.1 Land and mortgage registries. Registries pertaining to land (or land use rights) and mortgages are typically established solely for recording interests of this nature, although permanent fixtures and attachments to the land may be treated as subject to recordation in the place of the underlying real property. Land and mortgage registries are typically established by jurisdiction, region, or locale where the property is situated; ideally, they should provide for integrated, computerized search features.

A4.2 Charge registries. Registries pertaining to movable assets of enterprises should be integrated and established nationally, with filings made on the basis of the enterprise or business name, ideally in a centralized, computerized registry situated in the jurisdiction or location where the enterprise or business entity has been incorporated or has its main place of registration.

A4.3 Specialized registries. Special registries are beneficial in the case of certain kinds of assets, such as aircraft, vessels, vehicles, and certain types of intellectual property (such as trademarks and copyrights).

5. COMMERCIAL ENFORCEMENT SYSTEMS

World Bank Principle

Commercial Enforcement Systems [A5]

A5.1 Enforcement of unsecured debt. A functional credit system should be supported by mechanisms and procedures that provide for efficient, transparent, and reliable methods for satisfying creditors' rights by means of court proceedings or nonjudicial dispute resolution procedures. To the extent

possible, a country's legal system should provide for executive or abbreviated procedures for debt collection.⁵

A5.2 Enforcement of secured debt. Enforcement systems should provide efficient, cost-effective, transparent, and reliable methods (both nonjudicial and judicial) for enforcing a security interest over assets. Enforcement proceedings should provide for prompt realization of the rights obtained in secured assets, designed to enable maximum recovery according to market-based asset values.

⁵ Enforcement under this principle aims primarily at the treatment with respect to proceedings to recover against corporate debtors. Where enforcement proceedings involve individuals or persons, reasonable exemptions may need to be adopted to allow individuals or persons to retain those assets indispensable to the subsistence of the debtor and his/her family. Any such exemptions should be clearly defined and narrowly tailored.

B. RISK MANAGEMENT AND CORPORATE WORKOUT**1. CREDIT INFORMATION SYSTEMS****World Bank Principle****Credit Information Systems [B1]**

A modern credit-based economy requires access to complete, accurate, and reliable information concerning borrowers' payment histories. Key features of a credit information system should address the following:

- B1.1 Legal framework.** The legal environment should not impede but ideally should provide the framework for the creation and operation of effective credit information systems. Libel laws and similar laws have the potential to constrain good-faith reporting by credit information systems. While the accuracy of information reported is an important value, credit information systems should be afforded legal protection sufficient to encourage their activities without eliminating incentives to maintain high levels of accuracy.
- B1.2 Operations.** Permissible uses of information from credit information systems should be clearly circumscribed, especially regarding information about individuals. Measures should be employed to safeguard information contained in the credit information system. Incentives should exist to maintain the integrity of the database. The legal system should create incentives for credit information services in order to collect and maintain a broad range of information on a significant part of the population.
- B1.3 Public policy.** Legal controls on the type of information collected and distributed by credit information systems can be used to advance public policies. Legal controls on the type of information collected and distributed by credit information systems may be used to combat certain types of societal discrimination, such as discrimination based on race, gender, national origin, marital status, political affiliation, or union membership. There may be public policy reasons for restricting the ability of credit information services to report negative information beyond a certain period of time, such as five or seven years.
- B1.4 Privacy.** Subjects of information in credit information systems should be made aware of the existence of such systems and be able to access information about themselves. In particular, they should be notified when information from such systems is used to make adverse decisions about them. They should be able to dispute inaccurate or incomplete information and mechanisms should exist to have such disputes investigated and have errors corrected.
- B1.5 Enforcement/Supervision.** One benefit of the establishment of a credit information system is to permit regulators to assess an institution's risk exposure, thus giving the institution the tools and incentives to assess that exposure itself. Enforcement systems should provide efficient, inexpensive, transparent, and predictable methods for resolving disputes concerning the operation of credit information systems. Both nonjudicial and judicial enforcement methods should be considered. Sanctions for violations of laws regulating credit information systems should be sufficiently stringent to encourage compliance but not so stringent as to discourage the operation of such systems.

2. DIRECTOR AND OFFICER ACCOUNTABILITY**World Bank Principle****Director and Officer Accountability [B2]**

Laws governing director and officer liability for decisions detrimental to creditors made when an enterprise is in financial distress or insolvent should promote responsible corporate behavior while fostering reasonable

risk taking. At a minimum, standards should hold management accountable for harm to creditors resulting from willful, reckless, or grossly negligent conduct.⁶

3. ENABLING LEGISLATIVE FRAMEWORK

World Bank Principle

Enabling Legislative Framework [B3]

Corporate workouts and restructurings should be supported by an enabling environment, one that encourages participants to engage in consensual arrangements designed to restore an enterprise to financial viability. An environment that enables debt and enterprise restructuring includes laws and procedures that:

- B3.1** Require disclosure of or ensure access to timely, reliable, and accurate financial information on the distressed enterprise;
- B3.2** Encourage lending to, investment in, or recapitalization of viable financially distressed enterprises;
- B3.3** Flexibly accommodate a broad range of restructuring activities, involving asset sales, discounted debt sales, debt write-offs, debt reschedulings, debt and enterprise restructurings, and exchange offerings (debt-to-debt and debt-to-equity exchanges);
- B3.4** Provide favorable or neutral tax treatment with respect to losses or write-offs that are necessary to achieve a debt restructuring based on the real market value of the assets subject to the transaction;
- B3.5** Address regulatory impediments that may affect enterprise reorganizations; and
- B3.6** Give creditors reliable recourse to enforcement, as outlined in Section A, and to liquidation and/or reorganization proceedings, as outlined in Section C.

4. INFORMAL WORKOUT PROCEDURES

World Bank Principle

Informal Workout Procedures [B4]

- B4.1** An informal workout process may work better if it enables creditors and debtors to use informal techniques, such as voluntary negotiation or mediation or informal dispute resolution. While a reliable method for timely resolution of inter-creditor differences is important, the financial supervisor should play a facilitating role consistent with its regulatory duties as opposed to actively participating in the resolution of inter-creditor differences.
- B4.2** Where the informal procedure relies on a formal reorganization, the formal proceeding should be able to quickly process the informal, pre-negotiated agreement.
- B4.3** In the context of a systemic crisis, or where levels of corporate insolvency have reached systemic levels, informal rules and procedures may need to be supplemented by interim framework enhancement measures in order to address the special needs and circumstances encountered with a view to encouraging restructuring. Such interim measures are typically designed to cover the crisis and resolution period without undermining the conventional proceedings and systems.

UNCITRAL Recommendations

Expedited reorganization proceedings (part two, chap. IV, paras. 76-94)

Purpose of legislative provisions

⁶ This principle addresses only accountabilities of directors and officers in the period when a company is facing an imminent risk of insolvency. General principles for corporate governance and officer and director liability to their shareholders are dealt with under the OECD Principles for Corporate Governance.

The purpose of provisions relating to insolvency procedures that combine voluntary restructuring negotiations and acceptance of a plan with an expedited procedure conducted under the insolvency law for court confirmation of that plan is:

- (a) To recognize that voluntary restructuring negotiations, which typically involve restructuring of the debt due to lenders and other institutional creditors and major non-institutional creditors where their participation is crucial to the restructuring, but not involving all categories of creditor, is a cost-effective, efficient tool for the rescue of financially troubled businesses;
- (b) To encourage and facilitate the use of informal negotiation;
- (c) To develop a procedure under the insolvency law that will:
 - (i) To preserve the benefits of voluntary restructuring negotiations where a majority of each affected class of creditors agree to a plan;
 - (ii) To minimize time delays and expense and ensure that the plan negotiated and agreed in voluntary restructuring negotiations is not lost;
 - (iii) To bind those minority members of each affected class of creditors and equity holders who do not accept the negotiated plan;
 - (iv) To be based upon the same substantive requirements, but shortened time periods, as reorganization proceedings under the insolvency law, including essentially the same safeguards; and
- (d) To suspend, with appropriate safeguards, requirements in other laws that may prevent or inhibit the use of processes that delay the invocation of the insolvency law.⁷

Content Of Legislative Provisions

Commencement Of Expedited Reorganization Proceedings

160. The insolvency law should specify that expedited proceedings can be commenced on the application of any debtor that:

- (a) Is or is likely to be generally unable to pay its debts as they mature;
- (b) Has negotiated a reorganization plan and had it accepted by each affected class of creditors; and
- (c) Satisfies the jurisdictional requirements for commencement of full reorganization proceedings under the insolvency law.

161. The insolvency law may additionally specify that an expedited proceeding can be commenced on the application of any debtor if:

- (a) The debtor's liabilities exceed or are likely to exceed its assets; and
- (b) The requirements of recommendation 160 subparagraphs (b) and (c) are satisfied.

Application requirements

162. The insolvency law should specify that the following additional materials should accompany an application for commencement of expedited reorganization proceedings:

- (a) The reorganization plan and disclosure statement;
- (b) A description of the voluntary restructuring negotiations that preceded the making of the application for commencement, including the information provided to affected creditors to enable them to

⁷ For example, requirements for unanimous consent for adjustment of indebtedness outside of insolvency proceedings, liability for directors where the debtor continues to trade during the period when the out-of-court negotiations are being conducted, that do not recognize obligations for credit extended during such a period, and that restrict conversion of debt to equity.

make an informed decision about the plan;

(c) Certification that unaffected creditors are being paid in the ordinary course of business and that the plan does not modify or affect the rights or claims of unaffected creditors without their agreement;

(d) A report of the votes of affected classes of creditors demonstrating that those classes have accepted the plan by the majorities specified in the insolvency law;

(e) A financial analysis or other evidence that demonstrates that the plan satisfies all applicable requirements for reorganization; and

(f) A list of the members of any creditor committee formed during the course of the voluntary restructuring negotiations.

Commencement

163. The insolvency law should specify that the application for commencement will automatically commence the proceedings or that the court will be required to promptly determine whether the debtor satisfies the requirements of recommendations 160 or 161 and if so, commence proceedings.

Effect of commencement

164. The insolvency law should specify that:

(a) Provisions of the insolvency law that apply to full reorganization proceedings will also apply to expedited proceedings unless specified as modified or not applicable;⁸

(b) Unless otherwise determined by the court, the effects of commencement should be limited to the debtor, individual creditors and classes of creditors and equity holders whose rights are modified or affected by the plan;

(c) Any creditor committee formed during the course of the voluntary restructuring negotiations should be treated as a creditor committee appointed under the insolvency law; and

(d) A hearing on the confirmation of the plan by the court should be held as expeditiously as possible.

Notice of commencement

165. The insolvency law should specify that notice of the commencement of expedited proceedings is to be given to affected creditors and affected equity holders. The notice should specify:

(a) The amount of each affected creditor's claim according to the debtor;

(b) The time period for submitting a claim in a different amount if the affected creditor disagrees with the debtor's statement of the claim, and the place where the claim can be submitted;

(c) The time and procedure for challenging claims submitted by other parties;

(d) The time and place for the hearing on confirmation of the plan, and for the submission of any objection to confirmation; and

(e) The impact of the plan on equity holders.

Confirmation of the plan

⁸ Provisions of the insolvency law that generally would *not* be applicable or that could be modified would include: full claim filing; notice and time periods for plan approval; the post-commencement mechanics of providing the plan and disclosure statement to creditors and other interested parties and for solicitation of votes and voting on the plan; appointment of an insolvency representative (who generally would not be appointed unless required by the plan); provisions on amendment of the plan after confirmation. An exception to the provisions of the insolvency law applicable to full reorganization proceedings would be that creditors not affected by the plan would be paid in the ordinary course of business during the implementation of the plan.

166. The insolvency law should specify that the court will confirm the plan if:

- (a) The plan satisfies the substantive requirements for confirmation of a plan in full reorganization proceedings, in so far as those requirements apply to affected creditors and affected equity holders;
- (b) The notice given and the information provided to affected creditors and affected equity holders during the voluntary restructuring negotiations was sufficient to enable them to make an informed decision about the plan and any pre-commencement solicitation of acceptances to the plan complied with applicable law;
- (c) Unaffected creditors are being paid in the ordinary course of business and the plan does not modify or affect the rights or claims of unaffected creditors without their agreement; and
- (d) The financial analysis submitted with the application demonstrates that the plan satisfies all applicable requirements for reorganization.

Effect of a confirmed plan

167. The insolvency law should specify that the effect of a plan confirmed by the court should be limited to the debtor and those creditors and equity holders affected by the plan.

Failure of implementation of a confirmed plan

168. The insolvency law may specify that where there is a substantial breach by the debtor of the terms of the plan or an inability to implement the plan, the court may close the judicial proceedings and parties in interest may exercise their rights at law.

5. REGULATION OF WORKOUT AND RISK MANAGEMENT PRACTICES

World Bank Principle

Regulation of Workout and Risk Management Practices [B5]

- B5.1** A country's financial sector (possibly with the informal endorsement and assistance of the central bank, finance ministry, or bankers' association) should promote the development of a code of conduct on a voluntary, consensual procedure for dealing with cases of corporate financial difficulty in which banks and other financial institutions have a significant exposure, especially in markets where corporate insolvency has reached systemic levels.
- B5.2** In addition, good risk-management practices should be encouraged by regulators of financial institutions and supported by norms that facilitate effective internal procedures and practices supporting the prompt and efficient recovery and resolution of nonperforming loans and distressed assets.

C. COMMERCIAL INSOLVENCY**1. KEY OBJECTIVES AND POLICIES****World Bank Principle****Key Objectives and Policies [C1]**

Though country approaches vary, effective insolvency systems should aim to:

- (i) Integrate with a country's broader legal and commercial systems;
- (ii) Maximize the value of a firm's assets and recoveries by creditors;
- (iii) Provide for the efficient liquidation of both nonviable businesses and those where liquidation is likely to produce a greater return to creditors and the reorganization of viable businesses;
- (iv) Strike a careful balance between liquidation and reorganization, allowing for easy conversion of proceedings from one procedure to another;
- (v) Provide for equitable treatment of similarly situated creditors, including similarly situated foreign and domestic creditors;
- (vi) Provide for timely, efficient, and impartial resolution of insolvencies;
- (vii) Prevent the improper use of the insolvency system;
- (viii) Prevent the premature dismemberment of a debtor's assets by individual creditors seeking quick judgments;
- (ix) Provide a transparent procedure that contains, and consistently applies, clear risk allocation rules and incentives for gathering and dispensing information;
- (x) Recognize existing creditor rights and respect the priority of claims with a predictable and established process; and
- (xi) Establish a framework for cross-border insolvencies, with recognition of foreign proceedings.

UNCITRAL Recommendations**Designing the Key Objectives And Structure Of An Effective And Efficient Insolvency Law** (part one, chap. I, paras. 4-27)

1. In order to establish and develop an effective insolvency law, the following key objectives should be considered:
 - (a) Provide certainty in the market to promote economic stability and growth;
 - (b) Maximize value of assets;
 - (c) Strike a balance between liquidation and reorganization;
 - (d) Ensure equitable treatment of similarly situated creditors;
 - (e) Provide for timely, efficient and impartial resolution of insolvency;
 - (f) Preserve the insolvency estate to allow equitable distribution to creditors;
 - (g) Ensure a transparent and predictable insolvency law that contains incentives for gathering and dispensing information; and
 - (h) Recognize existing creditors rights and establish clear rules for ranking of priority claims.
2. The insolvency law should include provisions addressing both reorganization and liquidation of a debtor.
3. The insolvency law should recognize rights and claims arising under law other than the

insolvency law, whether domestic or foreign, except to the extent of any express limitation set forth in the insolvency law.

4. The insolvency law should specify that where a security interest is effective and enforceable under law other than the insolvency law, it will be recognized in insolvency proceedings as effective and enforceable.

5. The insolvency law should include a modern, harmonized and fair framework to address effectively instances of cross-border insolvency. Enactment of the UNCITRAL Model Law on Cross-Border Insolvency is recommended

6. The recommendations in the *Legislative Guide* have been designed to address each of the key objectives and achieve an appropriate balance between them.⁷ In order to design an effective and efficient insolvency law, the following common features should be considered:

- (a) Identifying the debtors that may be subject to insolvency proceedings, including those debtors which may require a special insolvency regime;
- (b) Determining when insolvency proceedings may be commenced and the type of proceeding that may be commenced, the party that may request commencement and whether the commencement criteria should differ depending upon the party requesting commencement;
- (c) The extent to which the debtor should be allowed to retain control of the business once insolvency proceedings commence, or be displaced and an independent party (in the *Legislative Guide* referred to as the “insolvency representative”) appointed to supervise and manage the debtor, and the distinction to be made between liquidation and reorganization in that regard;
- (d) Identification of the assets of the debtor that will be subject to the insolvency proceedings and constitute the insolvency estate;
- (e) Protection of the insolvency estate against the actions of creditors, the debtor itself and the insolvency representative and, where the protective measures apply to secured creditors, the manner in which the economic value of the security interest will be protected during the insolvency proceedings;
- (f) The manner in which the insolvency representative may deal with contracts entered into by the debtor before the commencement of proceedings and in respect of which both the debtor and its counterparty have not fully performed their respective obligations;
- (g) The extent to which set-off or netting rights can be enforced or will be protected, notwithstanding the commencement of insolvency proceedings;
- (h) The manner in which the insolvency representative may use or dispose of assets of the insolvency estate;
- (i) The extent to which the insolvency representative can avoid certain types of transaction that result in the interests of creditors being prejudiced;
- (j) In the case of reorganization, preparation of the reorganization plan and the limitations, if any, that will be imposed on the content of the plan, the preparer of the plan and the conditions required for its approval and implementation;
- (k) Rights and obligations of the debtor;
- (l) Duties and functions of the insolvency representative;
- (m) Functions of the creditors and creditor committee;
- (n) Costs and expenses relating to the insolvency proceedings;
- (o) The treatment of claims and their ranking for the purposes of distributing the proceeds of liquidation;
- (p) Distribution of the proceeds of liquidation;
- (q) Discharge or dissolution of the debtor; and
- (r) Conclusion of the proceedings.

2. COMMENCEMENT – DUE PROCESS: NOTIFICATION AND INFORMATION**World Bank Principle****Due Process: Notification and Information [C2]**

Effectively protecting the rights of parties with an interest in a proceeding requires that such parties have a right to be heard on and to receive proper notice of matters that affect their rights, and that such parties be afforded access to information relevant to protecting their rights or interests and to efficiently resolving disputes. To achieve these objectives, the insolvency system should:

- C2.1** Afford timely and proper notice to interested parties in a proceeding concerning matters that affect their rights. In insolvency proceedings, there should be procedures for appellate review that support timely, efficient, and impartial resolution of disputed matters. As a general rule, appeals do not stay insolvency proceedings, although the court may have power to do so in specific cases.
- C2.2** Require the debtor to disclose relevant information pertaining to its business and financial affairs in detail sufficient to enable the court, creditors, and affected parties to reasonably evaluate the prospects for reorganization. The system should also provide for independent comment on and analysis of that information. Provision should be made for the possible examination of directors, officers and other persons with knowledge of the debtor's financial position and business affairs, who may be compelled to give information to the court, the insolvency representative, and the creditor's committee.
- C2.3** Provide for the retention of professional experts to investigate, evaluate, or develop information that is essential to key decision-making. Professional experts should act with integrity, impartiality, and independence.

UNCITRAL Recommendations

The UNCITRAL Legislative Guide contains a number of recommendations relating to the provision of notice that are included in remaining sections of this document under each topic. For ease of reference these recommendations are:

Commencement of insolvency proceedings: 19, 22-25;

Denial of an application to commence: 20;

Dismissal of insolvency proceedings: 29;

Orders for provisional measures: 42;

Disposal of assets: 55-56, 58;

Use of cash proceeds: 59;

Post-commencement finance: 66-67;

Continuation and rejection of contracts: 76;

Meetings of creditors: 128;

Amendment of a reorganization plan: 156;

Commencement of expedited reorganization proceedings: 165;

Denial of claims: 177, 181.

Obligations of the debtor (part two, chap. III, paras. 22-33)

110. The insolvency law should clearly specify the debtor's obligations in respect of insolvency proceedings. Those obligations should arise on the commencement of, and continue throughout, those proceedings. The obligations should include obligations:

- (a) To cooperate with and assist the insolvency representative to perform its duties;
- (b) To provide accurate, reliable and complete information relating to its financial position and business affairs that might be requested by the court, the insolvency representative, creditors and/or the

creditor committee, including lists of:

- (i) Transactions occurring prior to commencement that involved the debtor or the assets of the debtor;
- (ii) Ongoing court, arbitration or administrative proceedings, including enforcement proceedings;
- (iii) Assets, liabilities, income and disbursements;
- (iv) Debtors and their obligations; and
- (v) Creditors and their claims prepared in cooperation with the insolvency representative and revised and amended by the debtor as claims are verified and admitted or denied;

(c) To cooperate with the insolvency representative to enable the insolvency representative to take effective control of the estate and to facilitate or cooperate in the recovery by the insolvency representative of the assets, or control of the assets of the estate, wherever located and business records; and

(d) Where the debtor is a natural person, to provide notice to the court if it proposes or is forced to leave its habitual place of residence and, where the debtor is a legal person, to obtain the consent of the court or the insolvency representative to the movement of its the headquarters.

Confidentiality (part two, chap. III, paras. 28, 52 and 115)

111. The insolvency law should specify protections for information provided by the debtor or concerning the debtor that is commercially sensitive or confidential.

Creditor representation (part two, chap. III, paras. 75-88)

129. The insolvency law should facilitate the active participation of creditors in insolvency proceedings such as through a creditor committee, a special representative or other mechanism for representation. The insolvency law should specify whether a committee or other representation is required in all insolvency proceedings. Where the interests and categories of creditors involved in insolvency proceedings are diverse and participation will not be facilitated by the appointment of a single committee or representative, the insolvency law may provide for the appointment of different creditor committees or representatives.

Party in Interest's Right To Be Heard And To Appeal (part two, chap. III, paras. 116-120)

Right to Be Heard And To Request Review

137. The insolvency law should specify that a party in interest have a right to be heard on any issue in the insolvency proceedings that affects its rights, obligations or interests. For example, a party in interest should be entitled to:

- (a) Object to any act that requires court approval;
- (b) Request review by the court of any act for which court approval was not required or not requested; and
- (c) Request any relief available to it in insolvency proceedings.

Right of Appeal

138. The insolvency law should specify that a party in interest may appeal from any order of the court in the insolvency proceedings that affects its rights, obligations or interests.

3. COMMENCEMENT – ELIGIBILITY**World Bank Principle****Eligibility [C3]**

The insolvency proceeding should apply to all enterprises or corporate entities, including state-owned enterprises.⁹ Exceptions should be limited, clearly defined, and should be dealt with through a separate law or through special provisions in the insolvency law.

UNCITRAL Recommendations**Purpose of legislative provisions**

The purpose of provisions on eligibility and jurisdiction is to establish:

- (a) The types of debtor that are subject to the insolvency law;
- (b) The types of debtor that may be excluded from the insolvency law;
- (c) [...] ¹⁰
- (d) [...].

Contents of legislative provisions**Eligibility** (part two, chap. I, paras. 1-11)

(8) The insolvency law should govern insolvency proceedings against all debtors that engage in economic activities, whether natural or legal persons, including state-owned enterprises,¹¹ and whether or not those economic activities are conducted for profit.

(9) Exclusions from the application of the insolvency law should be limited and clearly identified in the insolvency law.¹²

4. COMMENCEMENT: APPLICABILITY AND ACCESSIBILITY**World Bank Principle****Commencement: Applicability and Accessibility [C4]**

- C4.1** Access to the system should be efficient and cost-effective. Both debtors and creditors should be entitled to apply for insolvency proceedings.
- C4.2** Commencement criteria and presumptions about insolvency should be clearly defined in the law. The preferred test to commence an insolvency proceeding should be the debtor's inability to pay debts as they mature, although insolvency may also exist where the debtor's liabilities exceed the value of its assets, provided that the values of assets and liabilities are measured on the basis of fair-market values.¹³

⁹ Ideally, the insolvency process should apply to SOEs, or alternatively, exceptions of SOEs should be clearly defined and based upon compelling state policy.

¹⁰ On jurisdiction, see below, 15. International Considerations.

¹¹ It is not intended that the *Guide* would apply to the insolvency of States, sub-national governments, municipalities and other similar types of organization, except to the extent that they are a "state-owned enterprise".

¹² Highly regulated organizations such as banks and insurance companies may require specialized treatment that can appropriately be provided in a separate insolvency regime or through special provisions in the general insolvency law. Some SOEs, such as those involved in sensitive sectors of the economy might also be excluded.

¹³ A single or dual approach may be adopted, although where only a single test is adopted it should be based on the liquidity approach for determining insolvency – that is, the debtor's inability to pay due debts.

C4.3 Debtors should have easy access to the insolvency system upon showing proof of basic criteria (insolvency or financial difficulty).

C4.4 Where the application for commencement of a proceeding is made by a creditor, the debtor should be entitled to prompt notice of the application, an opportunity to defend against the application, and a prompt decision by the court on the commencement of the case or the dismissal of the creditor's application.

UNCITRAL Recommendations

Commencement of proceedings (part two, chap. I, paras. 20-79)

Purpose of legislative provisions

The purpose of provisions on commencement of insolvency proceedings is:

- (a) To facilitate access for debtors and creditors to the remedies provided by the law;
- (b) To establish commencement criteria that are transparent and certain;
- (c) To enable applications for insolvency proceedings to be made and dealt with in a speedy, efficient and cost effective manner;
- (d) To establish safeguards to protect both debtors and creditors from improper use of the application procedure; and
- (e) To establish requirements for effective notification of commencement of proceedings.

Contents of legislative provisions

Commencement standard

Persons permitted to apply

14. The insolvency law should specify the parties permitted to make an application for commencement of insolvency proceedings, which should include the debtor and any of its creditors.¹⁴

Debtor application

15. The insolvency law should specify that insolvency proceedings can be commenced on the application of a debtor if the debtor can show either that:

- (a) It is or will be generally unable to pay its debts as they mature; or
- (b) Its liabilities exceed the value of its assets.¹⁵

Creditor applications

16. The insolvency law should specify that insolvency proceedings can be commenced on the application of a creditor if it can be shown that either:

- (a) The debtor is generally unable to pay its debts as they mature; or
- (b) The debtor's liabilities exceed the value of its assets.

Presumption that the debtor is unable to pay

17. The insolvency law may establish a presumption that, if the debtor fails to pay one or more of its mature debts, and the whole of the debt is not subject to a legitimate dispute or offset in an amount equal to or greater than the amount of the debt claimed, the debtor is generally unable to pay its debts.¹⁶

¹⁴ This would include a government authority that is a creditor of the debtor.

¹⁵ The intention of this recommendation and the recommendation on creditor applications is to allow legislators flexibility in developing commencement standards, based on a single or dual test approach. Where the insolvency law adopts a single test, it should be based on the debtor's inability to pay debts as they mature (cessation of payments test) and not on the balance sheet test. Where the insolvency law contains both tests (cessation of payments and balance sheet tests), proceedings can be commenced if one of the tests can be satisfied.

¹⁶ Where the debtor has not paid a mature debt and the creditor has obtained a judgement against the debtor in respect of that debt, there would be no need for a presumption to establish that the debtor was unable to pay its debts. The debtor could rebut the presumption by showing, for example, that it was able to pay its debts; that the debt was subject to a legitimate dispute or offset; or that the debt was not mature. The recommendations on notice of commencement provide

Commencement on debtor application

18. The insolvency law should specify that where the application for commencement is made by the debtor:

- (a) The application for commencement will automatically commence the insolvency proceedings; or
- (b) The court will promptly determine its jurisdiction and whether the debtor is eligible and the commencement standard has been met and if so, commence insolvency proceedings.

Commencement on creditor application

19. The law generally should specify that, where a creditor makes the application for commencement:

- (a) Notice of the application promptly is given to the debtor;¹⁷
- (b) The debtor be given the opportunity to respond to the application, by contesting the application, consenting to the application or, where the application seeks liquidation, requesting the commencement of reorganization proceedings; and
- (c) The court will promptly determine its jurisdiction and whether the debtor is eligible and the commencement standard has been met and if so, commence insolvency proceedings.¹⁸

Denial of an application to commence proceedings

20. The insolvency law should specify that, where the decision to commence proceedings is to be made by the court, the court may deny the application to commence and, where appropriate, impose costs or sanctions against the applicant, if it determines that:

- (a) It does not have jurisdiction or the debtor is ineligible or does not meet the commencement standard; or
- (b) The application is an improper use of the law.

21. Where the application was made by a creditor, the insolvency law should specify that the debtor promptly be given notice of the decision to deny.

Notice of commencement of proceedings

22. The insolvency law should establish procedures for giving notice of the commencement of insolvency proceedings.

- General notice

23. The insolvency law should specify that the means of giving notice of the commencement of insolvency proceedings must be appropriate¹⁹ to ensure that the information is likely to come to the attention of parties in interest.²⁰ The insolvency law should specify the party responsible for giving that notice.

- Notice to creditors

24. The insolvency law should specify that notice of the commencement of proceedings be given to creditors individually, unless the court considers that, under the circumstances, some other form of notice would be more appropriate.²¹

protection for the debtor by requiring notice of the application for commencement of proceedings to be given to the debtor and providing the debtor with an opportunity to rebut the presumption.

¹⁷ Where the debtor's whereabouts is unknown and it cannot be contacted, the general law may provide relevant rules concerning the giving of notice in such circumstances.

¹⁸ A determination that the commencement standard has been met may involve consideration of whether the debt is subject to a legitimate dispute or offset in an amount equal to or greater than the amount of the debt. The existence of such a set-off may be a ground for dismissal of the application (see above, paras. 61-63).

¹⁹ The question of what is appropriate in a particular case will also involve considerations of cost-effectiveness and the insolvency law should not require, for example, expensive publication in a national newspaper, when publication in a local paper will suffice.

²⁰ General notice would generally be provided by way of making the information available in a publication such as an official government gazette, a widely circulated national, regional or local newspaper, through electronic means, or through relevant public registries.

²¹ The obligation to prepare the list of creditors to be given notice is dealt with under obligations of the insolvency representative and the debtor (see UNCITRAL Insolvency Guide, part two, chap. III, paras. 22-27 and 49-51).

Content of notice

25. The insolvency law should specify that the notice of commencement of insolvency proceedings is to include:

- (a) Information concerning submission of claims, including the time and place for submission;
- (b) The procedure and form requirements for the submission of claims;
- (c) The consequences of failure to submit a claim in accordance with paragraphs (a) and (b) above; and
- (d) Information concerning verification of claims, application of the stay and its effects, and meetings of creditors.

Debtor With Insufficient Assets

26. The insolvency law should specify the treatment of debtors whose assets and sources of revenue are insufficient to meet the costs of administering the insolvency proceedings. Different approaches may be taken including:

- (a) Denial of the application, except where the debtor is an individual who would be entitled to a discharge; or
- (b) Commencement of the proceedings, where different mechanisms for appointment and remuneration of the insolvency representative may be available.²²

Dismissal of Insolvency Proceedings

27. The insolvency law should permit the court to dismiss proceedings if, after commencement, the court determines, for example, that:

- (a) The proceedings constitute an improper use of the insolvency law; or
- (b) The debtor was ineligible or did not meet the commencement standard at the time of commencement.

28. The insolvency law should specify that where proceedings are dismissed, the court may impose costs or sanctions, where appropriate, against the applicant for commencement of the proceedings.

29. The insolvency law should require notice of a decision to dismiss proceedings to be given.

5. PROVISIONAL MEASURES AND EFFECTS OF COMMENCEMENT**World Bank Principle****Provisional Measures and Effects of Commencement [C5]**

- C5.1** When an application has been filed, but before the court has rendered a decision, provisional relief or measures should be granted when necessary to protect the debtor's assets and the interests of stakeholders, subject to affording appropriate notice to affected parties.
- C5.2** The commencement of insolvency proceedings should prohibit the unauthorized disposition of the debtor's assets and suspend actions by creditors to enforce their rights or remedies against the debtor or the debtor's assets. The injunctive relief (stay) should be as wide and all-encompassing as possible, extending to an interest in assets used, occupied, or in the possession of the debtor.
- C5.3** A stay of actions by secured creditors also should be imposed in liquidation proceedings to enable higher recovery of assets by sale of the entire business or its productive units, and in reorganization proceedings where the collateral is needed for the reorganization. The stay should be of limited, specified duration, strike a proper balance between creditor protection and insolvency proceeding objectives, and provide for relief from the stay by application to the court based on clearly established grounds when the insolvency proceeding objectives or the protection of the

²² On mechanisms for appointment, see UNCITRAL Insolvency Guide, part two, chap. III, paras. 44-47; on remuneration, part two, chap. III, paras. 53-59.

secured creditor's interests in its collateral are not achieved. Exceptions to the general rule on a stay of enforcement actions should be limited and clearly defined.

UNCITRAL Recommendations

Protection and Preservation Of The Insolvency Estate (part two, chap. II, paras. 25-73)

Purpose of Legislative Provisions

The purpose of provisions on the protection and preservation of the estate is:

- (a) To establish measures to ensure that the value of the estate is not diminished by the actions of the debtor, creditors or third parties;
- (b) To determine the scope of those measures and the actions and parties to which they apply;
- (c) To establish the method, time and duration of application of those measures; and
- (d) To establish the grounds for relief from those measures.

Contents Of Legislative Provisions

Provisional Measures²³

39. The insolvency law should specify that the court may grant relief of a provisional nature, at the request of the debtor, creditors or third parties, where relief is needed to protect and preserve the value of the assets of the debtor²⁴ or the interests of creditors, between the time an application to commence insolvency proceedings is made and commencement of the proceedings,²⁵ including:

- (a) Staying execution against the assets of the debtor, including actions to make security interests effective against third parties and enforcement of security interests;
- (b) Entrusting the administration or supervision of the debtor's business, which may include the power to use and dispose of assets in the ordinary course of business, to an insolvency representative or other person²⁶ designated by the court;
- (c) Entrusting the realization of all or part of the assets of the debtor to an insolvency representative or other person designated by the court, in order to protect and preserve the value of assets of the debtor that, by their nature or because of other circumstances, are perishable, susceptible to devaluation or otherwise in jeopardy; and
- (d) Any other relief of the type applicable or available on commencement of proceedings under recommendations 46 and 48.

Indemnification in Connection With Provisional Measures

40. The insolvency law may provide the court with the power:

- (a) To require the applicant for provisional measures to provide indemnification and, where appropriate, to pay costs or fees; or
- (b) To impose sanctions in connection with an application for provisional measures.

Balance of Rights Between The Debtor And Insolvency Representative

41. The insolvency law should clearly specify the balance of the rights and obligations between the debtor and any insolvency representative appointed as a provisional measure. Between the time an application for commencement of insolvency proceedings is made and commencement of those proceedings, the debtor is entitled to continue to operate its business and to use and dispose of assets in

²³ These articles follow the corresponding articles of the UNCITRAL Model Law on Cross-Border Insolvency, see article 19 (see UNCITRAL Insolvency Guide, annex III).

²⁴ The reference to assets in paragraphs (a)-(c) is intended to be limited to assets that would be part of the insolvency estate once proceedings commence.

²⁵ The insolvency law should indicate the time of effect of an order for provisional measures, for example, at the time of the making of the order, retrospectively from the commencement of the day on which the order is made or some other specified time (see UNCITRAL Insolvency Guide, part two, chap. III, para. 44).

²⁶ The term "other person" in recommendation 39, paragraphs (b) and (c), is not intended to include the debtor.

the ordinary course of business, except to the extent restricted by the court.

Notice

42. The insolvency law should specify that, unless the court limits or dispenses with the need to provide notice, appropriate notice is to be given to those parties in interest affected by:

- (a) An application or court order for provisional measures (including an application for review and modification or termination); and
- (b) A court order for additional measures applicable on commencement, unless the court limits or dispenses with the need to provide notice.

Ex Parte Provisional Measures

43. The insolvency law should specify that, where the debtor or other party in interest affected by a provisional measure is not given notice of the application for that provisional measure, the debtor or other party in interest affected by the provisional measures has the right, upon urgent application, to be heard promptly²⁷ on whether the relief should be continued.

Modification or Termination Of Provisional Measures

44. The insolvency law should specify that the court, at its own motion or at the request of the insolvency representative, the debtor, a creditor or any other person affected by the provisional measures, may review and modify or terminate those measures.

Termination of Provisional Measures

45. The insolvency law should specify that provisional measures terminate when:

- (a) An application for commencement is denied;
- (b) An order for provisional measures is successfully challenged under recommendation 43; and
- (c) The measures applicable on commencement take effect, unless the court continues the effect of the provisional measures.

Measures Applicable On Commencement

46. The insolvency law should specify that, on commencement of insolvency proceedings:²⁸

- (a) Commencement or continuation of individual actions or proceedings²⁹ concerning the assets of the debtor, and the rights, obligations or liabilities of the debtor are stayed;
- (b) Actions to make security interests effective against third parties and to enforce security interests are stayed;³⁰
- (c) Execution or other enforcement against the assets of the estate is stayed;
- (d) The right of a counterparty to terminate any contract with the debtor is suspended;³¹ and
- (e) The right to transfer, encumber or otherwise dispose of any assets of the estate is suspended.³²

²⁷ Any time limit included in the insolvency law should be short in order to prevent the loss of value of the debtor's business.

²⁸ These measures would generally be effective as at the time of the making of the order for commencement.

²⁹ See UNCITRAL Model Law on Cross-Border Insolvency, article 20 (see UNCITRAL Insolvency Guide, annex III). It is intended that the individual actions referred to in subparagraph (a) of recommendation 46 would also cover actions before an arbitral tribunal. It may not always be possible, however, to implement the automatic stay of arbitral proceedings, such as where the arbitration does not take place in the State but in a foreign location.

³⁰ If law other than the insolvency law permits those security interests to be made effective within certain specified time periods, it is desirable that the insolvency law recognize those periods and permit the interest to be made effective where the commencement of insolvency proceedings occurs before expiry of the specified time period. Where law other than the insolvency law does not include such time periods, the stay applicable on commencement would operate to prevent the security interest being made effective. (For further discussion, see UNCITRAL Insolvency Guide, part two, chap. II, para. 32 and the UNCITRAL Legislative Guide on Secured Transactions).

³¹ See UNCITRAL Insolvency Guide, part two, chap. II, paras. 114-119. This recommendation is not intended to preclude the termination of a contract if the contract provides for a termination date that happens to fall after the commencement of insolvency proceedings.

Exceptions to the Application Of The Stay

47. The insolvency law may permit exceptions to the application of the stay or suspension under recommendation 46 and, where it does so, those exceptions should be clearly stated. Paragraph (a) of recommendation 46 should not affect the right to commence individual actions or proceedings to the extent necessary to preserve a claim against the debtor.³³

Additional measures Available On Commencement

48. The insolvency law should specify that the court may grant relief additional to the measures applicable on commencement.³⁴

Duration of Measures Automatically Applicable On Commencement

49. The insolvency law should specify that the measures applicable on commencement of insolvency proceedings remain effective throughout those proceedings until:

- (a) The court grants relief from the measures;³⁵
- (b) In reorganization proceedings, a reorganization plan becomes effective;³⁶ or
- (c) In the case of secured creditors in liquidation proceedings, a fixed time period specified in the law expires,³⁷ unless it is extended by the court for a further period on a showing that:
 - (i) An extension is necessary to maximize the value of assets for the benefit of creditors; and
 - (ii) The secured creditor will be protected against diminution of the value of the encumbered asset in which it has a security interest.

Protection From Diminution Of The Value Of Encumbered Assets

50. The insolvency law should specify that, upon application to the court, a secured creditor should be entitled to protection of the value of the assets in which it has a security interest. The court may grant appropriate measures of protection that may include:

- (a) Cash payments by the estate;
- (b) Provision of additional security interests; or
- (c) Such other means as the court determines.

Relief From Measures Applicable On Commencement

51. The insolvency law should specify that a secured creditor may request the court to grant relief from the measures applicable on commencement of insolvency proceedings on grounds that may include that:

- (a) The encumbered asset is not necessary to a prospective reorganization or sale of the debtor's business;
- (b) The value of the encumbered asset is diminishing as a result of the commencement of insolvency proceedings and the secured creditor is not protected against that diminution of value; and
- (c) In reorganization, a plan is not approved within any applicable time limits.

³² The limitation on the right to transfer, encumber or otherwise dispose of assets of the estate may be subject to an exception in those cases where the continued operation of the business by the debtor is authorized and the debtor can transfer, encumber or otherwise dispose of assets in the ordinary course of business.

³³ See UNCITRAL Model Law on Cross-Border Insolvency, art. 20, para. 3 and Guide to Enactment, paras. 151 and 152 (see UNCITRAL Insolvency Guide, annex III). Where an issue arises as to quantification of a claim, the court may be requested to consider whether relief from the stay can be provided to enable an action or proceeding to be commenced for that purpose.

³⁴ The additional relief that may be available will depend upon the types of measures available in a particular jurisdiction and what measures, in addition to the measures applicable on commencement (such as under recommendation 46), might be appropriate in a particular insolvency proceeding.

³⁵ Relief should be granted on the grounds included in recommendation 51.

³⁶ A plan may become effective upon approval by creditors or following confirmation by the court, depending upon the requirements of the insolvency law (see UNCITRAL Insolvency Guide³, part two, chap. IV, paras. 54 and following).

³⁷ It is intended that the stay should apply to secured creditors only for a short period of time, such as between 30 and 60 days, and that the insolvency law should clearly state the period of application.

6. MANAGEMENT**World Bank Principle****Management [C6]**

- C6.1** In liquidation proceedings, management should be replaced by an insolvency representative with authority to administer the estate in the interest of creditors. Control of the estate should be surrendered immediately to the insolvency representative. In creditor-initiated filings, where circumstances warrant, an interim administrator with limited functions should be appointed to monitor the business to ensure that creditor interests are protected.
- C6.2** There are typically three preferred approaches in reorganization proceedings: (i) exclusive control of the proceeding is entrusted to an independent insolvency representative; or (ii) governance responsibilities remain invested in management; or (iii) supervision of management is undertaken by an impartial and independent insolvency representative or supervisor. Under the second and third approaches, complete administrative power should be shifted to the insolvency representative if management proves incompetent or negligent or has engaged in fraud or other misbehavior.

UNCITRAL Recommendations**The Debtor** (part two, chap. III, paras. 1-34)**Purpose of legislative provisions**

The purpose of provisions concerning the debtor is:

- (a) To establish the rights and obligations of the debtor during the insolvency proceedings;
- (b) To address the remedies for failure of the debtor to meet its obligations; and
- (c) To address issues relating to management of the debtor in insolvency proceedings.

Content of legislative provisions**Rights**

Right to be heard See recommendation 137.

Right to Participate And Request Information

108. The insolvency law should specify that the debtor is entitled to participate in the insolvency proceedings, and to obtain information relating to those proceedings from the insolvency representative and the court.

Right to Retain Property To Preserve The Personal Rights Of The Debtor

109. Where the debtor is a natural person, the insolvency law should specify that the debtor is entitled to retain those assets excluded from the estate by the law.³⁸

Obligations of the debtor

110. The insolvency law should clearly specify the debtor's obligations in respect of insolvency proceedings. Those obligations should arise on the commencement of, and continue throughout, those proceedings. The obligations should include obligations:

- (a) To cooperate with and assist the insolvency representative to perform its duties;
- (b) To provide accurate, reliable and complete information relating to its financial position and

³⁸ See UNCITRAL Insolvency Guide, part two, chap. II, paras. 17-21 and recommendation 38.

- business affairs that might be requested by the court, the insolvency representative, creditors and/or the creditor committee, including lists of:³⁹
- (i) Transactions occurring prior to commencement that involved the debtor or the assets of the debtor;
 - (ii) Ongoing court, arbitration or administrative proceedings, including enforcement proceedings;
 - (iii) Assets, liabilities, income and disbursements;
 - (iv) Debtors and their obligations; and
 - (v) Creditors and their claims prepared in cooperation with the insolvency representative and revised and amended by the debtor as claims are verified and admitted or denied;
- (c) To cooperate with the insolvency representative to enable the insolvency representative to take effective control of the estate and to facilitate or cooperate in the recovery by the insolvency representative of the assets, or control of the assets of the estate, wherever located⁴⁰ and business records; and
- (d) Where the debtor is a natural person, to provide notice to the court if it proposes or is forced to leave its habitual place of residence and, where the debtor is a legal person, to obtain the consent of the court or the insolvency representative to the movement of its the headquarters.

Confidentiality

111. The insolvency law should specify protections for information provided by the debtor or concerning the debtor⁴¹ that is commercially sensitive or confidential.

The Debtor's Role In Continuation Of The Business

112. The insolvency law should specify the role of the debtor in the continuing operation of the business during insolvency proceedings. Different approaches may be taken, including:
- (a) Retention of full control of the business (debtor in possession), with appropriate protections including varying levels of control of the debtor and provision for displacement of the debtor in specified circumstances;⁴²
 - (b) Limited displacement, where the debtor may continue to operate the business on a day-to-day basis, subject to the supervision of an insolvency representative, in which event the division of responsibilities between the debtor and the insolvency representative should be specified in the law; or
 - (c) Total displacement of the debtor from any role in the business and the appointment of an insolvency representative.

113. The insolvency law should specify, where the debtor is a debtor in possession, those functions of the insolvency representative that may be performed by the debtor in possession.

Sanctions for The Debtor's Failure To Comply With Its Obligations

114. The insolvency law should permit the imposition of sanctions for the debtor's failure to comply with its obligations under the insolvency law.

7. CREDITORS AND THE CREDITORS' COMMITTEE

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³⁹ Subject to allowing the debtor the time necessary to collect the relevant information.

⁴⁰ See the UNCITRAL Model Law on Cross-Border Insolvency (UNCITRAL Insolvency Guide, annex III).

⁴¹ Information provided by the debtor may include information in control of the debtor, owned by the debtor or a third party, and information concerning the debtor may be provided by creditors, financial institutions and others.

⁴² It should be noted that this option relies on a well-developed court structure and the application of protections that operate to displace the debtor in certain circumstances. (For a more detailed discussion, see UNCITRAL Insolvency Guide, part two, chap. III, paras. 16-18.)

Creditors and the Creditors' Committee [C7]

- C7.1** The role, rights, and governance of creditors in proceedings should be clearly defined. Creditor interests should be safeguarded by appropriate means that enable creditors to effectively monitor and participate in insolvency proceedings to ensure fairness and integrity, including by creation of a creditors' committee as a preferred mechanism, especially in cases involving numerous creditors.
- C7.2** Where a committee is established, its duties and functions, and the rules for the committee's membership, quorum and voting, and the conduct of meetings should all be specified by the law. The committee should be consulted on non-routine matters in the case and have the ability to be heard on key decisions in the proceeding. The committee should have the right to request relevant and necessary information from the debtor. It should serve as a conduit for processing and distributing that information to other creditors and for organizing creditors to decide on critical issues. In reorganization proceedings, creditors should be entitled to participate in the selection of the insolvency representative.

UNCITRAL Recommendations**Creditors – Participation In Insolvency Proceedings** (part two, chap. III, 75-115)**Purpose of legislative provisions**

The purpose of provisions on participation of creditors in insolvency proceedings is:

- (a) To facilitate participation of creditors in insolvency proceedings;
- (b) To provide a mechanism for the appointment of a creditor committee or other creditor representative where to do so would facilitate the participation of creditors in the insolvency proceedings;
- (c) To ensure the right of creditors to access information on the insolvency proceedings; and
- (d) To specify the functions and responsibilities of the creditor committee or other representative.

Contents of legislative provisions**Right to be heard**

See recommendations 133 and 137.

Confidentiality

See recommendation 111.

Participation by creditors

126. The insolvency law should specify that creditors, both secured and unsecured, are entitled to participate in insolvency proceedings and identify what that participation may involve in terms of the functions that may be performed.

Voting by creditors

127. The insolvency law should specify the matters on which a vote of creditors is required and establish the relevant eligibility and voting requirements. In particular, the insolvency law should require creditors to vote on approval or rejection of a reorganization plan.

Convening meetings of creditors

128. The insolvency law may require a first meeting of creditors to be convened within a specified period of time after commencement to discuss matters specified in the insolvency law. The insolvency law may also permit the court, the insolvency representative or creditors holding a specific percentage of the total value of unsecured claims to request the convening of any other meeting of creditors and specify the circumstances in which such a meeting may be convened. The insolvency law should specify the party responsible for giving notice of such a meeting to creditors.

Creditor representation

129. The insolvency law should facilitate the active participation of creditors in insolvency proceedings such as through a creditor committee, a special representative or other mechanism for representation.⁴³ The insolvency law should specify whether a committee or other representation is required in all insolvency proceedings. Where the interests and categories of creditors involved in insolvency proceedings are diverse and participation will not be facilitated by the appointment of a single committee or representative, the insolvency law may provide for the appointment of different creditor committees or representatives.

130. Where the insolvency law permits a creditor committee or representative to be appointed, the relationship between the creditors and the creditor committee or representative should be clearly specified.⁴⁴ The insolvency law should specify how the costs of the creditor committee would be paid.

Creditors That May Be Appointed To A Creditor Committee

131. The insolvency law should specify the creditors that are eligible to be appointed to a committee. Creditors who may not be appointed to a creditor committee would include related persons and others who for any reason might not be impartial. The insolvency law should specify whether or not a creditor's claim must be admitted before the creditor is entitled to be appointed to a committee.

Mechanism for appointment to a creditor committee

132. The insolvency law should establish a mechanism for appointment of a creditor committee. Different approaches may include selection of the creditor committee by creditors or appointment by the court or other administrative body.

Rights and Functions Of A Creditor Committee

133. The insolvency law should specify the rights and functions of the creditor committee in insolvency proceedings, which may include:

- (a) Providing advice and assistance to the insolvency representative or the debtor in possession;
- (b) Participating in development of the reorganization plan;
- (c) Receiving notice of and being consulted on matters in which their class has an interest, including the sale of assets outside the ordinary course of business;
- (d) The right to hear the insolvency representative at any time; and
- (e) The right to be heard in the proceedings.

Employment and Remuneration Of Professionals By A Creditor Committee

134. The insolvency law should permit a creditor committee, subject to approval by the court, to select, employ and remunerate professionals that may be needed to assist the creditor committee to perform its functions. The insolvency law should specify how the costs and remuneration of those professionals would be paid.

Liability of Members Of A Creditor Committee

135. The insolvency law should specify that members of a creditor committee are exempt from liability for their actions in their capacity as members of the committee unless they are found to have acted fraudulently or to be guilty of willful misconduct.

Removal and Replacement Of Members Of A Creditor Committee

136. The insolvency law should specify the grounds for removal of members of a creditor committee and provide for their replacement.

⁴³ See UNCITRAL Insolvency Guide, part two, chap. III, paras. 2-21 and recommendations 112 and 113 on the continuing role of the debtor in reorganization. Where the debtor remains in possession of the business, a creditor committee or other creditor representative will have an important role to play in overseeing and, where necessary, reporting on the activities of the debtor.

⁴⁴ In particular, the insolvency law should specify the distribution of functions and powers between the creditors and the creditor committee and the mechanism for resolution of disputes between the creditors and the creditor committee.

8. COLLECTION, PRESERVATION, ADMINISTRATION AND DISPOSITION OF ASSETS**World Bank Principle****Collection, Preservation, Administration, and Disposition of Assets [C8]**

- C8.1** The insolvency estate should include all of the debtor's assets, including encumbered assets and assets obtained after the commencement of the case. Assets excluded from the insolvency estate should be strictly limited and clearly defined by the law.
- C8.2** After the commencement of the insolvency proceedings, the court or the insolvency representative should be allowed to take prompt measures to preserve and protect the insolvency estate and the debtor's business. The system for administering the insolvency estate should be flexible and transparent and enable disposal of assets efficiently and at the maximum values reasonably attainable. Where necessary, the system should allow assets to be sold free and clear of security interests, charges, or other encumbrances, subject to preserving the priority of interests in the proceeds from the assets disposed.
- C8.3** The rights and interests of a third-party owner of assets should be protected where its assets are used during the insolvency proceedings by the insolvency representative and/or the debtor in possession.

UNCITRAL Recommendations**Assets Constituting The Insolvency Estate** (part two, chap. II, paras. 1-24)**Purpose of legislative provisions**

The purpose of provisions relating to the insolvency estate is:

- (a) To identify those assets which will be included in the estate, including the debtor's interests in encumbered assets and in third-party-owned assets; and
- (b) To identify the assets, if any, that will be excluded from the estate.

Contents of legislative provisions**Assets constituting the estate**

35. The insolvency law should specify that the estate should include:
- (a) Assets of the debtor,⁴⁵ including the debtor's interest in encumbered assets and in third party-owned assets;
- (b) Assets acquired after commencement of the insolvency proceedings; and
- (c) Assets recovered through avoidance and other actions.

36. In the case of insolvency proceedings commenced where the debtor has its centre of main interests, the insolvency law should specify that the estate should include all assets of the debtor wherever located.⁴⁶

Time of constitution of the estate

37. The insolvency law should specify the date from which the estate is to be constituted, being either the date of application for commencement or the effective date of commencement of insolvency proceedings.

⁴⁵ Ownership of assets would be determined by reference to the relevant applicable law, where the term "assets" is defined broadly to include property, rights and interest of the debtor, including the debtor's rights and interests in third-party-owned assets.

⁴⁶ Where the insolvency law adopts a universal approach, as recommended here, the law should also address the issue of recognition of foreign proceedings, see the UNCITRAL Model Law on Cross-Border Insolvency (UNCITRAL Insolvency Guide, annex III).

Assets Excluded From The Estate Where The Debtor Is A Natural Person⁴⁷

38. The insolvency law should specify the assets, if any, that are excluded from the estate where the debtor is a natural person.

Use and disposal of assets (part two, chap. II, paras. 74-93)**Purpose of legislative provisions**

The purpose of provisions on use and disposal of assets is:

- (a) To permit the use and disposal of assets, including encumbered assets in the insolvency proceedings and specify the conditions for their use and disposal;
- (b) To permit and specify the conditions for the use of third party owned assets;
- (c) To establish the limits to powers of use and disposal;
- (d) To notify creditors of proposed use and disposal, where appropriate; and
- (e) To provide for the treatment of burdensome assets.

Contents of legislative provisions**Power to Use And Dispose Of Assets Of The Estate**

52. The insolvency law should permit:

- (a) The use and disposal of assets of the estate (including encumbered assets) in the ordinary course of business, except cash proceeds; and
- (b) The use and disposal of assets of the estate (including encumbered assets) outside the ordinary course of business, subject to the requirements of recommendations 55 and 58.

Further Encumbrance Of Encumbered Assets

53. The insolvency law should specify that encumbered assets may be further encumbered, subject to the requirements of recommendations 65-67.

Use of Third Party Owned Assets

54. The insolvency law should specify that the insolvency representative may use assets owned by a third party and in the possession of the debtor provided specified conditions are satisfied, including:

- (a) The interests of the third party will be protected against diminution in the value of the asset; and
- (b) The costs under the contract of continued performance of the contract and use of the asset will be paid as an administrative expense.

Procedure for notification of disposal

55. The insolvency law should specify that adequate notice of any disposal conducted outside the ordinary course of business be given to creditors⁴⁸ and that they have the opportunity to be heard by the court.

56. The insolvency law should specify that notification of public auctions be provided in a manner that will ensure that the information is likely to come to the attention of interested parties.

General methods of sale

57. The insolvency law should specify methods of sale for sales conducted outside the ordinary course of business that will maximize the price obtained for assets being sold in insolvency proceedings, and permit both public auctions and private sales.

Ability To Sell Assets Of The Estate Free And Clear Of Encumbrances And Other Interests

⁴⁷ Exclusions are generally not provided for legal person debtors. On the types of asset that may be excluded in respect of natural persons; see UNCITRAL Insolvency Guide, part two, chap. II, paras. 18-21.

⁴⁸ When the assets are encumbered assets or subject to other interests, recommendation 58 also applies.

58. The insolvency law should permit the insolvency representative to sell an asset that is encumbered or subject to other interest free and clear of that encumbrance and other interest, outside the ordinary course of business, provided that:

- (a) The insolvency representative gives notice of the proposed sale to the holder of the encumbrance or other interest;
- (b) The holder is given the opportunity to be heard by the court where they object to the proposed sale;
- (c) Relief from the stay has not been granted; and
- (d) The priority of interests in the proceeds of sale of the asset is preserved.

Use of cash proceeds

59. The insolvency law should permit the insolvency representative to use and dispose of cash proceeds if:

- (a) The secured creditor with a security interest in those cash proceeds consents to such use or disposal; or
- (b) The secured creditor was given notice of the proposed use or disposal and an opportunity to be heard by the court; and
- (c) The interests of the secured creditor will be protected against diminution in the value of the cash proceeds.

Urgent sales

60. The insolvency law should permit the urgent sales of an asset to be conducted outside the ordinary course of business, where the asset is by its nature or because of other circumstances, perishable, susceptible to devaluation or otherwise in jeopardy. The insolvency law may provide that prior approval of the court or of creditors is not required in such circumstances.

Disposal of Assets To Related Persons

61. The insolvency law should require any proposed disposal of an asset to related persons to be carefully scrutinized before being allowed to proceed.

Burdensome assets

62. The insolvency law should permit the insolvency representative to determine the treatment of any asset that is burdensome to the estate. In particular, the insolvency law may permit the insolvency representative to relinquish a burdensome asset following the provision of notice to creditors and the opportunity for creditors to object to the proposed action, except that where a secured claim exceeds the value of the encumbered asset, and the asset is not required for a reorganization or sale of the business as going concern, the insolvency law may permit the insolvency representative to relinquish the asset to the secured creditor without notice to other creditors.

9. STABILIZING AND SUSTAINING BUSINESS OPERATIONS

World Bank Principle

Stabilizing and Sustaining Business Operations [C9]

- C9.1** The business should be permitted to operate in the ordinary course. Transactions that are not part of the debtor's ordinary course of business activities should be subject to court review.
- C9.2** Subject to appropriate safeguards, the business should have access to commercially sound forms of financing, including on terms that afford a repayment priority under exceptional circumstances, to

enable the debtor to meet its ongoing business needs.

UNCITRAL Recommendations

Post-commencement finance (part two, chap. II, paras. 94-107)

Purpose of legislative provisions

The purpose of provisions on post-commencement finance is:

- (a) To facilitate finance to be obtained for the continued operation or survival of the business of the debtor or the preservation or enhancement of the value of the assets of the estate;
- (b) To ensure appropriate protection for the providers of post-commencement finance; and
- (c) To ensure appropriate protection for those parties whose rights may be affected by the provision of post-commencement finance.

Contents Of Legislative Provisions

Attracting And Authorizing Post-Commencement Finance

63. The insolvency law should facilitate and provide incentives for post-commencement finance to be obtained by the insolvency representative where the insolvency representative determines it to be necessary for the continued operation or survival of the business of the debtor or the preservation or enhancement of the value of the estate. The insolvency law may require the court to authorize or creditors to consent to the provision of post-commencement finance.

Priority for post-commencement finance

64. The insolvency law should establish the priority that may be accorded to post-commencement finance, ensuring at least the payment of the post-commencement finance provider ahead of ordinary unsecured creditors, including those unsecured creditors with administrative priority.

Security for post-commencement finance

65. The insolvency law should enable a security interest to be granted for repayment of post-commencement finance, including a security interest on an unencumbered asset, including an after-acquired asset, or a junior or lower priority security interest on an already encumbered asset of the estate.

66. The law⁴⁹ should specify that a security interest over the assets of the estate to secure post-commencement finance does not have priority ahead of any existing security interest over the same assets unless the insolvency representative obtains the agreement of the existing secured creditor(s) or follows the procedure in recommendation 67.

67. The insolvency law should specify that, where the existing secured creditor does not agree, the court may authorize the creation of a security interest having priority over pre-existing security interests provided specified conditions are satisfied, including:

- (a) The existing secured creditor was given the opportunity to be heard by the court;
- (b) The debtor can prove that it cannot obtain the finance in any other way; and
- (c) The interests of the existing secured creditor will be protected.⁵⁰

Effect of Conversion On Post-Commencement Finance

68. The insolvency law should specify that where reorganization proceedings are converted to liquidation, any priority accorded to post-commencement finance in the reorganization should continue to be recognized in the liquidation.⁵¹

⁴⁹ This rule may be in a law other than the insolvency law, in which case the insolvency law should note the existence of the provision.

⁵⁰ See UNCITRAL Insolvency Guide, part two, chap. II paras. 63-69.

⁵¹ The same order of priority may not necessarily be recognized. For example, post-commencement finance may rank in priority after administrative claims relating to the costs of the liquidation.

10. TREATMENT OF CONTRACTUAL OBLIGATIONS**World Bank Principle****Treatment of Contractual Obligations⁵² [C10]**

- C10.1** To achieve the objectives of insolvency proceedings, the system should allow interference with the performance of contracts where both parties have not fully performed their obligations. Interference may imply continuation, rejection, or assignment of contracts.
- C10.2** To gain the benefit of contracts that have value, the insolvency representative should have the option of performing and assuming the obligations under those contracts. Contract provisions that provide for termination of a contract upon either an application for commencement or the commencement of insolvency proceedings should be unenforceable subject to special exceptions.
- C10.3** Where the contract constitutes a net burden to the estate, the insolvency representative should be entitled to reject or cancel the contract, subject to any consequences that may arise from rejection.
- C10.4** Exceptions to the general rule of contract treatment in insolvency proceedings should be limited, clearly defined, and allowed only for compelling commercial, public, or social interests, such as in the following cases: (i) upholding general setoff rights, subject to rules of avoidance; (ii) upholding automatic termination, netting, and close-out provisions contained in financial contracts; (iii) preventing the continuation and assignment of contracts for irreplaceable and personal services where the law would not require acceptance of performance by another party; and (iv) establishing special rules for treating employment contracts and collective bargaining agreements.

UNCITRAL Recommendations**Treatment of Contracts** (part two, chap. II, paras. 108-147)**Purpose of legislative provisions**

The purpose of provisions on treatment of contracts is:

- (a) To establish the manner in which contracts, under which both the debtor and its counterparty have not yet fully performed their respective obligations, should be addressed in the insolvency law, including the relationship between the insolvency law and applicable law, with the objective of maximizing the value and reducing the liabilities of the estate;
- (b) To define the scope of the powers to deal with these contracts and the situations in which and by whom these powers may be exercised;
- (c) To identify the types of contract that should be excepted from the exercise of these powers; and
- (d) To identify the kinds of protection that will be available to counterparties to continued contracts.

Contents Of Legislative Provisions**Treatment Of Contracts Not Fully Performed**

69. The insolvency law should specify the treatment of contracts under which both the debtor and its counterparty have not yet fully performed their respective obligations.

Automatic Termination And Acceleration Clauses

70. The insolvency law should specify that any contract clause that automatically terminates or accelerates a contract upon the occurrence of any of the following events is unenforceable as against the insolvency representative and the debtor:

- (a) An application for commencement, or commencement, of insolvency proceedings;
- (b) The appointment of an insolvency representative.⁵³

⁵² Treatment of contracts typically also includes leases.

71. The insolvency law should specify the contracts that are exempt from the operation of recommendation 70, such as financial contracts, or subject to special rules, such as labour contracts.

Continuation or rejection

72. The insolvency law should specify that the insolvency representative may decide to continue the performance of a contract of which it is aware where continuation would be beneficial to the insolvency estate.⁵⁴ The insolvency law should specify that:

- (a) The right to continue applies to the contract as a whole; and
- (b) The effect of continuation is that all terms of the contract are enforceable.

73. The insolvency law may permit the insolvency representative to decide to reject a contract.⁵⁵ The insolvency law should specify that the right to reject applies to the contract as a whole.

Timing and Notice Of Decision To Continue Or Reject

74. The insolvency law should specify a time period within which the insolvency representative is required to make a decision to continue or reject a contract, which time period may be extended by the court.

75. The insolvency law should specify the time at which the rejection will be effective.

76. The insolvency law should specify that where a contract is continued or rejected, the counterparty is to be given notice of the continuation or rejection, including its rights with respect to submitting a claim and the time in which the claim should be submitted, and permit the counterparty to be heard by the court.

Counterparty's Right To Request A Decision

77. Notwithstanding recommendation 74, the insolvency law should permit a counterparty to request the insolvency representative (within any specified time limit) to make a prompt decision and, in the event that the insolvency representative fails to act, to request the court to direct the insolvency representative to make a decision to continue or reject a contract.

Consequences of Failure To Make A Decision

78. The insolvency law should specify the consequences of the failure of the insolvency representative to make a decision within the specified time period with respect to contracts of which it is aware. Failure by the insolvency representative to act within the specified time period should not operate to continue a contract of which the insolvency representative was not aware.⁵⁶

Continuation of Contracts Where The Debtor Is In Breach

79. The insolvency law should specify that where the debtor is in breach of a contract the insolvency representative can continue the performance of that contract, provided the breach is cured, the non-breaching counterparty is substantially returned to the economic position it was in before the breach, and the estate is able to perform under the continued contract.

Performance prior to continuation or rejection

80. The insolvency law should specify that the insolvency representative may accept or require performance from the counterparty to a contract prior to continuation or rejection of the contract. Claims of the counterparty arising from performance accepted or required by the insolvency representative prior to continuation or rejection of the contract should be payable as an administrative expense:

- (a) If the counterparty has performed the contract the amount of the administrative expense

⁵³ This recommendation would apply only to those contracts where such clauses could be overridden (see UNCITRAL Insolvency Guide, part two, chap. II, paras. 143-145 on exceptions) and is not intended to be exclusive, but to establish a minimum: the court should be able to examine other contractual clauses that would have the effect of terminating a contract on the occurrence of similar events.

⁵⁴ Provided the automatic stay on commencement of proceedings applies to prevent termination (pursuant to an automatic termination clause) of contracts with the debtor, all contracts should remain in place to enable the insolvency representative to consider the possibility of continuation, unless the contract has a termination date which happens to fall after the commencement of insolvency proceedings.

⁵⁵ An alternative to providing a power to reject contracts is the approach of those jurisdictions that provide that performance of a contract simply ceases unless the insolvency representative decides to continue its performance.

⁵⁶ See UNCITRAL Insolvency Guide, part two, chap. III, para. 24, which refers to the debtor's obligation to provide information, including a list of contracts not fully performed.

should be the contractual price of the performance; or

- (b) If the insolvency representative uses assets owned by a third party that are in the possession of the debtor subject to contract, that party should be protected against diminution of the value of those assets and have an administrative claim in accordance with subparagraph (a).

Damages for Subsequent Breach Of A Continued Contract

81. The insolvency law should specify that where a decision is made to continue performance of a contract, damages for the subsequent breach of that contract should be payable as an administrative expense.

Damages Arising From Rejection

82. The insolvency law should specify that any damages arising from the rejection of a pre-commencement contract would be determined in accordance with applicable law and should be treated as an ordinary unsecured claim. The insolvency law may limit claims relating to the rejection of a long-term contract.

Assignment of contracts

83. The insolvency law may specify that the insolvency representative can decide to assign a contract, notwithstanding restrictions in the contract, provided the assignment would be beneficial to the estate.

84. Where the counterparty objects to assignment of a contract, the insolvency law may permit the court to nonetheless approve the assignment provided:

- (a) The insolvency representative continues the contract;
- (b) The assignee can perform the assigned contractual obligations;
- (c) The counterparty is not substantially disadvantaged by the assignment; and
- (d) The debtor's breach under the contract is cured before assignment.

85. The insolvency law may specify that where the contract is assigned, the assignee will be substituted for the debtor as the contracting party with effect from the date of the assignment and the estate will have no further liability under the contract.

Post-commencement contracts

86. The insolvency law should specify that contracts entered into after the commencement of insolvency proceedings are post-commencement obligations of the estate. Claims arising from those contracts should be payable as an administrative expense.

Rights of set-off (part two, chap. II, paras. 204-207)

Purpose of legislative provisions

The purpose of provisions on set-off is:

- (a) To provide certainty with respect to the effect of the commencement of insolvency proceedings upon the exercise of set-off rights;
- (b) To specify the types of obligation that may be set-off after commencement of insolvency proceedings; and
- (c) To specify the effect of other provisions of the law (e.g. avoidance provisions and the stay) on the exercise of rights of set-off.

Contents of legislative provisions

100. The insolvency law should protect a general right of set-off existing under law other than the insolvency law that arose prior to the commencement of insolvency proceedings, subject to the application of avoidance provisions.

Financial contracts and netting (part two, chap. II, paras. 208-215)

Purpose of legislative provisions

The purpose of provisions on netting and set-off in the context of financial transactions on financial markets is to reduce the potential for systemic risk that could threaten the stability of financial

markets by providing certainty with respect to the rights of parties to a financial contract when one of those parties fails to perform for reasons of insolvency. These recommendations are not intended to apply to transactions that are not financial contracts and they would remain subject to the law applicable to set-off and netting.

Contents of legislative provisions

101. The insolvency law should recognize contractual termination rights associated with financial contracts that permit the termination of those contracts and the set-off and netting of outstanding obligations under those contracts promptly after the commencement of insolvency proceedings. Where the insolvency law stays the termination of contracts or limits the enforceability of automatic termination clauses on commencement of insolvency proceedings, financial contracts should be exempt from such limitations.⁵⁷

102. Once the financial contracts of the debtor have been terminated by a counterparty, the insolvency law should permit the counterparty to net or setoff obligations under those terminated financial contracts to establish a net exposure position relative to the debtor. This termination and set-off to establish a net exposure should be permitted regardless of whether the termination of the contracts occurs prior to or after the commencement of insolvency proceedings. Where the insolvency law limits or stays the exercise of set-off rights upon commencement of insolvency proceedings, set-off and netting of financial contracts should be exempt from such limitations.

103. Once the financial contracts of the debtor have been terminated, the insolvency law should permit counterparties to enforce and apply their security interest to obligations arising out of financial contracts. Financial contracts should be exempt from any stay under the insolvency law that applies to the enforcement of a security interest.

104. The insolvency law should specify that routine pre-bankruptcy transfers consistent with market practice, such as the putting up of margin for financial contracts⁵⁸ and transfers to settle financial contract obligations⁵⁹ should be exempt from avoidance.

105. The insolvency law should recognize and protect the finality of the netting, clearing and settlement of financial contracts through payment and settlement systems upon the insolvency of a participant in the system.

106. Recommendations 101 to 105 should apply to all transactions that are considered to be “financial contracts,” whether or not one of the counterparties is a financial institution.⁶⁰

107. Financial contracts should be defined broadly enough to encompass existing varieties of financial contracts and to accommodate new types of financial contracts as they appear.

11. ADMINISTRATION: AVOIDABLE TRANSACTIONS

World Bank Principle

Administration: Avoidable Transactions [C11]

C11.1 After the commencement of an insolvency proceeding, transactions by the debtor that are not consistent with the debtor’s ordinary course of business or engaged in as part of an approved

⁵⁷ This will allow market participants to extend credit based on “net” positions and make it impossible for the debtor to “cherry pick” contracts by performing some and breaching others, which is especially important with regard to financial contracts because of systemic risk.

⁵⁸ Margin is the process of posting additional cash or securities as a security for the transactions in accordance with a contractual formula that accounts for fluctuations in the market value of the contract and the existing security. For example, on a swap, a margin of 105 per cent might be required to maintain the termination value of the contract. If the security position falls to 100 per cent, an additional margin might have to be posted.

⁵⁹ In some circumstances, a settlement payment might be viewed as a preference. In the example of a swap, settlement payments are to be made monthly or upon termination of the contract based on the market value of the contract. These payments are not value for value transfers, but rather payment of an accrued debt obligation that has matured. In countries that have a fixed suspect period for all transactions occurring before commencement, such a payment might also be subject to avoidance.

⁶⁰ Even if a given financial contract does not involve a financial institution, the impact of the insolvency of a counterparty could entail systemic risk.

	administration should be avoided (cancelled), with narrow exceptions protecting parties who lacked notice.
C11.2	Certain transactions prior to the application for or the date of commencement of the insolvency proceeding should be avoidable (cancelable), including fraudulent and preferential transfers made when the enterprise was insolvent or that rendered the enterprise insolvent.
C11.3	The suspect period, during which payments are presumed to be preferential and may be set aside, should be reasonably short in respect to general creditors to avoid disrupting normal commercial and credit relations, but the period may be longer in the case of gifts or where the person receiving the transfer is closely related to the debtor or its owners.

UNCITRAL Recommendations

Avoidance Proceedings (part two, chap. II, paras. 148-203)

Purpose of legislative provisions

The purpose of avoidance provisions is:

- (a) To reconstitute the integrity of the estate and ensure the equitable treatment of creditors;
- (b) To provide certainty for third parties by establishing clear rules for the circumstances in which transactions occurring prior to the commencement of insolvency proceedings involving the debtor or the debtor's property may be considered injurious and therefore subject to avoidance;
- (c) To enable the commencement of proceedings to avoid those transactions; and
- (d) To facilitate the recovery of money or assets from persons involved in transactions that have been avoided.

Contents of legislative provisions

Avoidable transactions⁶¹

87. The insolvency law should include provisions that apply retroactively and are designed to overturn transactions, involving the debtor or assets of the estate and that have the effect of either reducing the value of the estate or upsetting the principle of equitable treatment of creditors. The insolvency law should specify the following types of transactions as avoidable:

- (a) Transactions intended to defeat, delay or hinder the ability of creditors to collect claims where the effect of the transaction was to put assets beyond the reach of creditors or potential creditors or to otherwise prejudice the interests of creditors;
- (b) Transactions where a transfer of an interest in property or the undertaking of an obligation by the debtor was a gift or was made in exchange for a nominal or less than equivalent value or for inadequate value that occurred at a time when the debtor was insolvent or as a result of which the debtor became insolvent (undervalued transactions); and
- (c) Transactions involving creditors where a creditor obtained, or received the benefit of, more than its pro rata share of the debtor's assets that occurred at a time when the debtor was insolvent (preferential transactions).

Security interests

88. The insolvency law should specify that notwithstanding that a security interest is effective and enforceable under law other than the insolvency law, it may be subject to the avoidance provisions of insolvency law on the same grounds as other transactions.

Establishing the suspect period

89. The insolvency law should specify that the transactions described in recommendation 87 subparagraphs (a)-(c) may be avoided if they occurred within a specified period (the suspect period)

⁶¹ The use of the word "transaction" in this section is intended to refer generally to the wide range of legal acts by which assets may be disposed of or obligations incurred including by way of a transfer, a payment, granting of a security interest, a guarantee, a loan or a release or an action to make a security interest effective against third parties, and may include a composite series of transactions.

calculated retroactively from a specified date, being either the date of application for or commencement of the insolvency proceedings. The insolvency law may specify different suspect periods for different types of transactions.

Transactions with related persons

90. The insolvency law may specify that the suspect period for avoidable transactions involving related persons is longer than for transactions with unrelated persons.

91. The insolvency law should specify the categories of persons with sufficient connection to the debtor to be treated as related persons.⁶²

Transactions exempt from avoidance actions

92. The insolvency law should specify the transactions that are exempt from avoidance, including financial contracts.

Conduct of avoidance proceedings

93. The insolvency law should specify that the insolvency representative has the principal responsibility to commence avoidance proceedings.⁶³ The insolvency law may also permit any creditor to commence avoidance proceedings with the agreement of the insolvency representative and, where the insolvency representative does not agree, the creditor may seek leave of the court to commence such proceedings.

Funding of avoidance proceedings

94. The insolvency law should specify that the costs of avoidance proceedings be paid as administrative expenses.

95. The insolvency law may provide alternative approaches to address the pursuit and funding of avoidance proceedings.

Time Limits For Commencement Of Avoidance Proceedings

96. The insolvency law or applicable procedural law should specify the time period within which an avoidance proceeding may be commenced. That time period should begin to run on the commencement of insolvency proceedings. In respect of transactions referred to in recommendation 87 that have been concealed and that the insolvency representative could not be expected to discover, the insolvency law may provide that the time period commences at the time of discovery.

Elements of Avoidance And Defences

97. The insolvency law should specify the elements to be proved in order to avoid a particular transaction, the party responsible for proving those elements and specific defences to avoidance. Those defences may include that the transaction was entered into in the ordinary course of business prior to commencement of insolvency proceedings. The law may also establish presumptions and permit shifts in the burden of proof to facilitate the conduct of avoidance proceedings.

Liability of Counterparties To Avoided Transactions

98. The insolvency law should specify that a counterparty to a transaction that has been avoided must return to the estate the assets obtained or, if the court so orders, make a cash payment to the estate for the value of the transaction. The insolvency law should determine whether the counterparty to an avoided transaction would have an ordinary unsecured claim.

99. The insolvency law may specify that where the counterparty does not comply with the court order avoiding the transaction, in addition to avoidance and any other remedy, a claim by the counterparty may be disallowed.

12. TREATMENT OF STAKEHOLDERS RIGHTS & PRIORITIES

⁶² "Related person" is defined in the glossary to the UNCITRAL Insolvency Guide (see Introduction, para. 12(jj)).

⁶³ Issues relevant to avoidance may also arise in proceedings commenced by a person other than the insolvency representative, where the insolvency representative raises avoidance by way of defence against enforcement.

World Bank Principle**Treatment of Stakeholder Rights and Priorities [C12]**

- C12.1** The rights of creditors and the priorities of claims established prior to insolvency proceedings under commercial or other applicable laws should be upheld in an insolvency proceeding to preserve the legitimate expectations of creditors and encourage greater predictability in commercial relationships. Deviations from this general rule should occur only where necessary to promote other compelling policies, such as the policy supporting reorganization, or to maximize the insolvency estate's value. Rules of priority should enable creditors to manage credit efficiently, consistent with the following additional principles:
- C12.2** The priority of secured creditors in their collateral should be upheld and, absent the secured creditor's consent, its interest in the collateral should not be subordinated to other priorities granted in the course of the insolvency proceeding. Distributions to secured creditors should be made as promptly as possible.
- C12.3** Following distributions to secured creditors from their collateral and the payment of claims related to the costs and expenses of administration, proceeds available for distribution should be distributed *pari passu* to the remaining general unsecured creditors,⁶⁴ unless there are compelling reasons to justify giving priority status to a particular class of claims. Public interests generally should not be given precedence over private rights. The number of priority classes should be kept to a minimum.
- C12.4** Workers are a vital part of an enterprise, and careful consideration should be given to balancing the rights of employees with those of other creditors.
- C12.5** In liquidation, equity interests or the owners of the business are not entitled to a distribution of the proceeds of assets until the creditors have been fully repaid. The same rule should apply in reorganization, although limited exceptions may be made under carefully stated circumstances that respect rules of fairness entitling equity interests to retain a stake in the enterprise.

UNCITRAL Recommendations**Priorities and distribution of proceeds** (part two, chap. V, paras. 51-81)**Purpose of Legislative Provisions****The Purpose Of Provisions On Priority And Distribution Is:**

- (a) To establish the order in which claims should be satisfied from the estate;
- (b) To ensure that similarly ranked creditors are satisfied proportionately out of the assets of the estate; and
- (c) To specify limited circumstances in which priority in distribution is permitted.

Contents of legislative provisions**Classes and Treatment Of Creditors Affected By Commencement Of Insolvency Proceedings**

185. The insolvency law should specify the classes of creditors that will be affected by the commencement of insolvency proceedings and the treatment of those classes in terms of priority and distribution.

Establishing an order for satisfaction of claims

186. The insolvency law should establish the order in which claims are to be satisfied from the estate.

Priority claims

187. The insolvency law should minimize the priorities accorded to unsecured claims. The law should set out clearly the classes of claims, if any, that will be entitled to be satisfied in priority in insolvency proceedings.

Secured claims

⁶⁴ Subject to any intercreditor agreements and contractual subordination provisions or where equitable subordination of a creditors claim may be appropriate.

188. The insolvency law should specify that a secured claim should be satisfied from the encumbered asset in liquidation or pursuant to a reorganization plan, subject to claims that are superior in priority to the secured claim, if any. Claims superior in priority to secured claims should be minimized and clearly set forth in the insolvency law. To the extent that the value of the encumbered asset is insufficient to satisfy the secured creditor's claim, the secured creditor may participate as an ordinary unsecured creditor.

Ranking of Claims Other Than Secured Claims

189. The insolvency law should specify that claims other than secured claims, are ranked in the following order:⁶⁵

- (a) Administrative costs and expenses;
- (b) Claims with priority;
- (c) Ordinary unsecured claims;
- (d) Deferred claims or claims subordinated under the law.

190. The insolvency law should specify that in the event there is a surplus after all claims have been satisfied in full, the surplus is to be returned to the debtor.

Distribution in liquidation

191. The insolvency law should provide, as a general principle, that similarly ranked claims are paid *pari passu*. All similarly ranked claims in a particular class should be paid in full before the next rank is paid.

192. The insolvency law should specify that in making a distribution the insolvency representative is to be required to make provision for submitted claims that are not yet finally admitted.

193. The insolvency law should specify that, in liquidation proceedings, distributions be made promptly and that interim distributions may be made.

13. CLAIMS AND CLAIMS RESOLUTION: CLAIMS FILING AND RESOLUTION

World Bank Principle

Claims and Claims Resolution: Claims Filing and Resolution [C13]

Procedures for notifying creditors and permitting them to file claims should be cost effective, efficient, and timely. While there must be a rigorous system of examining claims to ensure validity and resolve disputes, the delays inherent in resolving disputed claims should not be permitted to delay insolvency proceedings.

UNCITRAL Recommendations

Treatment of Creditor Claims (part two, chap. V, paras. 1-50)

Purpose of Legislative Provisions

The purpose of provisions on creditor claims is:

- (a) To define the claims that can or are required to be submitted and the treatment to be accorded to those claims;
- (b) To enable persons who have a claim against a debtor to submit claims against the estate;
- (c) To establish a mechanism for verification and admission of claims;
- (d) To provide for review of disputed claims; and
- (e) To ensure that similarly ranked creditors are treated equally.

Contents of legislative provisions

⁶⁵ The insolvency law may provide for further ranking of claims within each of the ranks set forth in paras. (a), (b) and (d). Where all creditors within a rank cannot be paid in full, the order of payment should reflect any further ranking specified in the insolvency law for claims of the same rank.

Requirement to submit

169. The insolvency law should require creditors who wish to participate in the proceedings to submit a claim, which should specify the basis and amount of the claim. The law should minimize the formalities associated with submission of claims. The insolvency law should permit claims to be submitted using different means, including mail and electronic means.

Undisputed claims

170. The insolvency law may permit claims that are undisputed to be admitted by reference to the list of creditors and claims prepared by the debtor in cooperation with the insolvency representative⁶⁶ or the court or the insolvency representative may require a creditor to provide evidence of its claim. The insolvency law should not require that in all cases a creditor must appear in person to prove its claim.

Claims That May Be Submitted

171. The insolvency law should specify that claims that may be submitted include all rights to payment that arise from acts or omissions of the debtor⁶⁷ prior to commencement of the insolvency proceedings, whether mature or not, whether liquidated or unliquidated, whether fixed or contingent. The law should identify claims that will not be affected by the insolvency proceedings.⁶⁸

Secured claims

172. The insolvency law should specify whether secured creditors are required to submit claims.

Equal Treatment Of Similarly Ranked Creditors

173. The insolvency law should specify that all similarly ranked creditors, regardless of whether they are domestic or foreign creditors, are to be treated equally with respect to the submission and processing of their claims.

Timing of Submission Of Claims

174. The insolvency law should specify the period of time after the effective date of commencement of proceedings within which claims may be submitted. That time period should be adequate to allow creditors to submit their claims.⁶⁹

Consequences of Failure To Submit A Claim

175. Where the insolvency law requires a creditor to submit a claim, the insolvency law should specify the consequences of failure to submit a claim within any period of time specified for submission.

Foreign currency claims

176. Where claims are denoted in foreign currency, the insolvency law should specify the circumstances in which those claims must be converted and the reasons for conversion. Where conversion is required, the insolvency law should specify that the claim will be converted into local currency by reference to a specified date, such as the effective date of commencement of insolvency proceedings.

Admission or denial of claims

177. The insolvency law should permit the insolvency representative to admit or deny any claim, in full or in part.⁷⁰ Where the claim is to be denied or subjected to treatment under recommendation 184 as a claim by a related person, whether in full or in part, notice of the reasons for the decision should be given to the creditor.

Unliquidated claims

178. The insolvency law should permit unliquidated claims to be admitted provisionally, pending

⁶⁶ See recommendation 110.

⁶⁷ This would include claims by third parties or a guarantor for payment arising from acts or omission of the debtor.

⁶⁸ Some insolvency laws provide, for example, that claims such as fines and penalties and taxes will not be affected by the insolvency proceedings. Where a claim is to be unaffected by the insolvency proceedings it would continue to exist and would not be included in any discharge.

⁶⁹ Where proceedings involve foreign creditors, longer time periods may be required to facilitate submission of claims. Also, it is desirable that claims be submitted at an early stage of the proceedings so that the insolvency representative will be aware of the claims involved, of the encumbered assets affected and of the value of those assets and claims.

⁷⁰ In some jurisdictions, the court may be required to ratify the decision of the insolvency representative.

determination of the amount of the claim by the insolvency representative.

Valuation of secured claims

179. The insolvency law should provide that the insolvency representative may determine the portion of a secured creditor's claim that is secured and the portion that is unsecured by valuing the encumbered asset.

Disputing a claim

180. The insolvency law should permit a party in interest to dispute any submitted claim, either before or after admission, and to request review of that claim by the court.

Review of Claims Denied Or Subjected To Special Treatment

181. The insolvency law should permit creditors whose claims have been denied or subjected to treatment under recommendation 184 as a claim by a related person, whether in full or in part, to request the court to review their claim. The insolvency law may specify a period of time after notification of the decision within which that request may be made.

Provisional Admission Of Disputed Claims

182. The insolvency law should specify that claims disputed in the insolvency proceedings could be admitted provisionally by the insolvency representative pending resolution of the dispute by the court.

Effects of admission

183. The insolvency law should specify the effects of admission, including provisional admission, of a claim. These effects may include:

- (a) Entitling the creditor to participate in the proceedings and to be heard;
- (b) Permitting the creditor to vote at a meeting of creditors, including on approval of a plan;
- (c) Determining the priority to which the creditor's claim is entitled;
- (d) Determining the amount for which the creditor is entitled to vote;
- (e) Except in the case of provisional admission of a claim, permitting the creditor to participate in a distribution.⁷¹

Claims by related persons

184. The insolvency law should specify that claims by related persons should be subject to scrutiny and, where justified:⁷²

- (a) The voting rights of the related person may be restricted;
- (b) The amount of the claim of the related person may be reduced; or
- (c) The claim may be subordinated.⁷³

14. REORGANIZATION PROCEEDINGS

World Bank Principle

Reorganization Proceedings [C14]

C14.1 The system should promote quick and easy access to the proceeding; assure timely and efficient administration of the proceeding; afford sufficient protection for all those involved in the proceeding; provide a structure that encourages fair negotiation of a commercial plan; and provide for approval of the plan by an appropriate majority of creditors. Key features and principles of a modern

⁷¹ However, when making a distribution, the insolvency representative may be required to take account of claims that have been provisionally admitted, or submitted but not yet admitted.

⁷² Sufficient justification may involve situations where the debtor is undercapitalized or there has been self-dealing, UNCITRAL Insolvency Guide, part two, chap. V, para. 48.

⁷³ On subordination, see below, UNCITRAL Insolvency Guide, part two, chap. V, paras. 55-61.

reorganization proceeding include the following:

- C14.2 Plan Formulation and Consideration.** There should be a flexible approach for developing the plan consistent with fundamental requirements designed to promote fairness and prevent commercial abuse.
- C14.3 Plan Voting and Approval.** For voting purposes, classes of creditors may be provided with voting rights weighted according to the amount of a creditor's claim. Claims and voting rights of insiders should be subject to special scrutiny and treated in a manner that will ensure fairness. Plan approval should be based on clear criteria aimed at achieving fairness among similar creditors, recognition of relative priorities, and majority acceptance, while offering opposing creditors or classes a dividend equal to or greater than they would likely receive in a liquidation proceeding. Where court confirmation is required, the court should normally defer to the decision of the creditors based on a majority vote. Failure to approve a plan within the stated time period, or any extended periods, is typically grounds for placing the debtor into a liquidation proceeding.
- C14.4 Plan Implementation and Amendment.** Effective implementation of the plan should be independently supervised. A plan should be capable of amendment (by vote of the creditors) if it is in the interests of the creditors. Where a debtor fails or is incapable of implementing the plan, this should be grounds for terminating the plan and liquidating the insolvency estate.
- C14.5 Discharge and Binding Effects.** The system should provide for plan effects to be binding with respect to forgiveness and to cancellation or alteration of debts. The effect of approval of the plan by a majority vote should bind all creditors, including dissenting minorities.
- C14.6 Plan revocation and closure.** Where approval of the plan has been procured by fraud, the plan should be reconsidered or set aside. Upon consummation and completion of the plan, provision should be made to swiftly close the proceedings and enable the enterprise to carry on its business under normal conditions and governance.

UNCITRAL Recommendations

Reorganization Plan (part two, chap. IV, paras. 1-75)

Purpose of legislative provisions

The purpose of provisions relating to the reorganization plan is:

- (a) To facilitate the rescue of businesses subject to the insolvency law, thereby preserving employment and, in appropriate cases, protecting investment;
- (b) To identify those businesses which are capable of reorganization;
- (c) To maximize the value of the estate;
- (d) To facilitate the negotiation and approval of a reorganization plan and establish the effects of approval, including that the plan should bind the debtor, creditors and other parties in interest;
- (e) To address the consequences of a failure to propose an acceptable reorganization plan or to secure approval of the plan, including conversion of the proceedings to liquidation in certain circumstances; and
- (f) To provide for the implementation of the reorganization plan and the consequences of failure of implementation.

Contents of legislative provisions

Proposal of a reorganization plan

139. The insolvency law should specify that a plan may be proposed on or after the making of an application to commence insolvency proceedings, or within a specified period of time after commencement of the insolvency proceedings:
- (i) The time period should be fixed by the insolvency law;
 - (ii) The court should be authorized to extend the time period in appropriate circumstances.

140. The insolvency law should specify that a plan may be proposed on or after the making of an application to commence insolvency proceedings, or within a specified period of time after commencement of the insolvency proceedings: where liquidation proceedings are converted to reorganization proceedings,

the insolvency law should also address the impact of conversion on time limits for proposal of a plan.

Preparation of a disclosure statement

141. The insolvency law should require a plan to be accompanied by a disclosure statement that will enable those entitled to vote on approval of the plan to make an informed decision about the plan. The party that prepares the plan should also prepare the disclosure statement.

Submission of the plan and disclosure statement

142. The insolvency law should provide a mechanism for submission of the plan and disclosure statement to creditors and equity holders.

Contents of a disclosure statement

143. The insolvency law should specify that the disclosure statement include:⁷⁴

- (a) A summary of the plan;
- (b) Information relating to the financial situation of the debtor including assets, liabilities and cash flow;
- (c) Non-financial information that might have an impact on the future performance of the debtor;
- (d) A comparison of the treatment afforded to creditors by the plan and what they would otherwise receive in liquidation;
- (e) The basis upon which the business would be able to keep trading and could be successfully reorganized;
- (f) Information showing that, having regard to the effect of the plan, adequate provision has been made for satisfaction of all obligations included in the plan; and
- (g) Information on the voting mechanisms applicable to approval of the plan.

Contents of a plan

144. The insolvency law should specify the minimum contents of a plan. The plan should:

- (a) Identify each class of creditors and the treatment provided for each class by the plan (e.g. how much they will receive and the timing of payment, if any);
- (b) Detail the treatment of equity holders;
- (c) Detail the terms and conditions of the plan;
- (d) Identify the debtor's role in implementation of the plan;
- (e) Identify those responsible for future management of the debtor and supervision of the implementation of the plan and indicate their affiliation with the debtor and their remuneration; and
- (f) Indicate how the plan will be implemented.

Voting mechanisms

145. The insolvency law should establish a mechanism for voting on approval of the plan. The mechanism should address the creditors and equity holders who are entitled to vote on the plan; the manner in which the vote will be conducted, either at a meeting convened for that purpose or by mail or other means, including electronic means and the use of proxies; and whether or not creditors and equity holders should vote in classes according to their respective rights.

146. The insolvency law should specify that a creditor or equity holder whose rights are modified or affected by the plan should not be bound to the terms of the plan unless that creditor or equity holder has been the given the opportunity to vote on approval of the plan.

147. The insolvency law should specify that where the plan provides that the rights of a creditor or equity holder or class of creditors or equity holders are not modified or affected by a plan, that creditor or equity

⁷⁴ Where the insolvency representative does not prepare, or is not involved in the preparation of, the plan and the statement, the insolvency representative should be required to comment on both instruments. Information included in the disclosure statement should be subject to the obligations of confidentiality, discussed in UNCITRAL Insolvency Guide, part two, chap. III, recommendation 111, and paras. 28, 52 and 115.

holder or class of creditors or equity holders is not entitled to vote on approval of the plan.

148. The insolvency law should specify that creditors entitled to vote on approval of the plan should be separately classified according to their respective rights and that each class should vote separately.

149. The insolvency law should specify that all creditors and equity holders in a class should be offered the same treatment.

Approval by classes

150. Where voting on approval of the plan is conducted by reference to classes, the insolvency law should specify how the vote achieved in each class would be treated for the purposes of approval of the plan. Different approaches may be taken, including requiring approval by all classes or approval by a specified majority of the classes, but at least one class of creditors whose rights are modified or affected by the plan must approve the plan.

151. Where the insolvency law does not require a plan to be approved by all classes, the insolvency law should address the treatment of those classes which do not vote to approve a plan that is otherwise approved by the requisite classes. That treatment should be consistent with the grounds set forth in recommendation 152.

Confirmation of an approved plan

152. Where the insolvency law requires court confirmation of an approved plan, the insolvency law should require the court to confirm the plan if the following conditions are satisfied:

- (a) The requisite approvals have been obtained and the approval process was properly conducted;
- (b) Creditors will receive at least as much under the plan as they would have received in liquidation, unless they have specifically agreed to receive lesser treatment;
- (c) The plan does not contain provisions contrary to law;
- (d) Administrative claims and expenses will be paid in full, except to the extent that the holder of the claim or expense agrees to different treatment; and
- (e) Except to the extent that affected classes of creditors have agreed otherwise, if a class of creditors has voted against the plan, that class shall receive under the plan full recognition of its ranking under the insolvency law and the distribution to that class under the plan should conform to that ranking.

Challenges to approval (where there is no requirement for confirmation)

153. Where a plan becomes binding on approval by creditors, without requiring confirmation by the court, the insolvency law should permit parties in interest, including the debtor, to challenge the approval of the plan. The insolvency law should specify criteria against which a challenge can be assessed, which should include:

- (a) Whether the grounds set forth in recommendation 152 are satisfied; and
- (b) Fraud, in which case the requirements of recommendation 154 should apply.

Challenges to a confirmed plan

154. The insolvency law should permit a confirmed plan to be challenged on the basis of fraud. The insolvency law should specify:

- (a) A time limit for bringing such a challenge calculated by reference to the time the fraud is discovered;
- (b) The party that may bring such a challenge; and
- (c) That the challenge should be heard by the court.

Amendment of a plan

155. The insolvency law should permit amendment of a plan and specify the parties that may propose amendments and the time at which the plan may be amended, including between submission and approval, approval and confirmation, after confirmation and during implementation, where the proceedings remain open.

Approval of amendments

156. The insolvency law should establish the mechanism for approval of amendments to a plan that has been approved by creditors. That mechanism should: require notice to be given to the creditors and other parties affected by the proposed modification; specify the party required to give notice; require the approval of creditors and other parties affected by the modification; and require the rules for confirmation (where confirmation is required) to be satisfied. The insolvency law should also specify the consequences of failure to secure approval of proposed amendments.

Supervision of implementation

157. The law may establish a mechanism for supervising implementation of the plan, which may include supervision by the court, by a court-appointed supervisor, by the insolvency representative, or by a creditor-appointed supervisor.⁷⁵

Conversion to liquidation

158. The insolvency law should provide that the court may convert reorganization proceedings to liquidation where:

- (a) A plan is not proposed within any time limit specified by the law and the court does not grant an extension of time;
- (b) A proposed plan is not approved;
- (c) An approved plan is not confirmed (where the insolvency law requires confirmation);
- (d) An approved or a confirmed plan is successfully challenged; or
- (e) There is substantial breach by the debtor of the terms of the plan or an inability to implement the plan.⁷⁶

Failure of implementation of a plan

159. The insolvency law may specify that where there is a substantial breach by the debtor of the terms of the plan or an inability to implement the plan, the court may close the judicial proceedings and parties in interest may exercise their rights at law.

Discharge (part two, chap. VI, paras. 1-15)**Purpose of legislative provisions**

The purpose of provisions on discharge is:

- (a) To enable an a natural person debtor to be finally discharged from liabilities for pre-commencement debts, thus providing a fresh start;
- (b) To establish the circumstances under which discharge will be granted and the terms of that discharge.

Contents of legislative provisions**Discharge of a natural person debtor in liquidation**

194. Where natural persons are eligible as debtors under the insolvency law, the issue of discharge of those debtors from liability for pre-commencement debts should be addressed. The insolvency law may specify that the discharge may not apply until after the expiration of a specified period of time following commencement, during which period the debtor is expected to cooperate with the insolvency representative. Upon the expiration of such time period, the debtor may be discharged where the debtor has not acted fraudulently and has cooperated with the insolvency representative in performing its obligations under the insolvency law. The insolvency law may specify that the discharge is to be revoked where it was obtained fraudulently.

195. Where the insolvency law provides that certain debts are excluded from a discharge, those debts should be kept to a minimum in order to facilitate the debtor's fresh start and be clearly set forth in the

⁷⁵ Where the proceedings involve a debtor-in-possession, or where the proceedings conclude on approval of the plan, it may not be necessary to appoint a supervisor.

⁷⁶ This course of action is only available where the proceedings remain open during implementation – see UNCITRAL Insolvency Guide, part two, chap. VI, paras. 18-19.

insolvency law.

196. Where the insolvency law provides that conditions may be attached to a debtor's discharge, those conditions should be kept to a minimum to facilitate the debtor's fresh start and should be clearly set forth in the insolvency law.

Conclusion of Proceedings (part two, chap. VI, paras. 16-19)

Purpose of legislative provisions

The purpose of provisions on conclusion of insolvency proceedings is to determine a procedure for closing the proceedings once their goal has been achieved.

Contents of legislative provisions

Reorganization

197. The law should specify the procedures by which reorganization proceedings should be closed.

Liquidation

198. The law should specify the procedures by which liquidation proceedings should be closed following final distribution or a determination that no distribution can be made.

15. INTERNATIONAL CONSIDERATIONS

World Bank Principle

International Considerations [C15]

Insolvency proceedings may have international aspects, and a country's legal system should establish clear rules pertaining to jurisdiction, recognition of foreign judgments, cooperation among courts in different countries, and choice of law. Key factors to effective handling of cross-border matters typically include:

- (i) A clear and speedy process for obtaining recognition of foreign insolvency proceedings;
- (ii) Relief to be granted upon recognition of foreign insolvency proceedings;
- (iii) Foreign insolvency representatives to have access to courts and other relevant authorities;
- (iv) Courts and insolvency representatives to cooperate in international insolvency proceedings; and
- (v) Non-discrimination between foreign and domestic creditors.

UNCITRAL Recommendations

Jurisdiction (part two, chap. I, paras. 12-19)

Purpose of legislative provisions

The purpose of provisions on eligibility and jurisdiction is to establish:

- (a) [..];⁷⁷
- (b) [..];
- (c) The debtors that have sufficient connection to a State to be subject to the insolvency law; and
- (d) The courts that have jurisdiction over the commencement and conduct of insolvency proceedings.

Contents of legislative provisions

⁷⁷ On eligibility, see above 4. Commencement: Applicability and Accessibility

10. The insolvency law should specify which debtors have sufficient connection to the State to be subject to its insolvency law. Different approaches may be taken to identifying appropriate connecting factors, but the grounds upon which a debtor can be subject to the insolvency law should include:⁷⁸

- (a) That the debtor has its centre of main interests in the State; or
- (b) That the debtor has an establishment in the State.

11. The insolvency law should establish a presumption that, in the absence of proof to the contrary, a legal person's centre of main interests is in the State in which it has its registered office, and a natural person's centre of main interests is in the State in which that person has their habitual residence.

12. The insolvency law should define "establishment" to mean "any place of operations where the debtor carries out a non-transitory economic activity with human means and goods or services".⁷⁹

Competent courts

13. The insolvency law should clearly indicate (or include a reference to the relevant law that establishes) the court that has jurisdiction over the commencement and conduct of insolvency proceedings, including matters arising in the course of those proceedings.

Applicable law in insolvency proceedings (part two, chap. I, paras. 80-91)

Purpose of legislative provisions

The purpose of provisions on the applicable law in insolvency proceedings is:

- (a) To facilitate commerce by recognizing, in insolvency proceedings, the rights and claims that arise before commencement of insolvency proceedings and the law that will apply to the validity and effectiveness of those rights and claims; and
- (b) To establish the law applicable in insolvency proceedings and exceptions, if any, to the application of that law.

Contents of legislative provisions

Law Applicable To Validity And Effectiveness Of Rights And Claims

30. The law applicable to the validity and effectiveness of rights and claims existing at the time of the commencement of insolvency proceedings should be determined by the private international law rules of the State in which insolvency proceedings are commenced.

Law Applicable In Insolvency Proceedings

31. The insolvency law of the State in which insolvency proceedings are commenced (*lex fori concursus*) should apply to all aspects of the commencement, conduct, administration and conclusion of those insolvency proceedings and their effects. These may include, for example:

- (a) Identification of the debtors that may be subject to insolvency proceedings;
- (b) Determination of when insolvency proceedings can be commenced and the type of proceeding that can be commenced, the party that can apply for commencement and whether the commencement criteria should differ depending upon the party applying for commencement;
- (c) Constitution and scope of the insolvency estate;
- (d) Protection and preservation of the insolvency estate;
- (e) Use or disposal of assets;
- (f) Proposal, approval, confirmation and implementation of a plan of reorganization;
- (g) Avoidance of certain transactions that could be prejudicial to certain parties;
- (h) Treatment of contracts;

⁷⁸This recommendation is intended to indicate minimum and non-exclusive grounds for commencing insolvency proceedings. Other grounds, such as presence of assets, are used in some jurisdictions, but are not recommended: see above, UNCITRAL Insolvency Guide, part two, chap. I, paras. 17-18 and the Guide to Enactment of the UNCITRAL Model Law, paras. 184-187, UNCITRAL Insolvency Guide (annex III).

⁷⁹ UNCITRAL Model Law, art. 2, para. (f) (see UNCITRAL Insolvency Guide, annex III).

- (i) Set-off;
- (j) Treatment of creditors;
- (k) Rights and obligations of the debtor;
- (l) Duties and functions of the insolvency representative;
- (m) Functions of the creditors and creditor committee;
- (n) Treatment of claims;
- (o) Ranking of claims;
- (p) Costs and expenses relating to the insolvency proceedings;
- (q) Distribution of proceeds;
- (r) Conclusion of the proceedings; and
- (s) Discharge.

Exceptions to the Application Of The Law Of The Insolvency Proceedings

32. Notwithstanding recommendation 31, the effects of insolvency proceedings on the rights and obligations of the participants in a payment or settlement system or in a regulated financial market should be governed solely by the law applicable to that system or market.

33. Notwithstanding recommendation 31, the effects of insolvency proceedings on rejection, continuation and modification of labour contracts may be governed by the law applicable to the contract.

34. Any exceptions additional to recommendations 32 and 33 should be limited in number and be clearly set forth or noted in the insolvency law

Treatment of creditor claims (part two, chap. V, paras. 10, 21-22),

Equal treatment of similarly ranked creditors

172. The insolvency law should specify that all similarly ranked creditors, regardless of whether they are domestic or foreign creditors, are to be treated equally with respect to the submission and processing of their claims.

Foreign currency claims

175. Where claims are denoted in foreign currency, the insolvency law should specify the circumstances in which those claims must be converted and the reasons for conversion. Where conversion is required, the insolvency law should specify that the claim will be converted into local currency by reference to a specified date, such as the effective date of commencement of insolvency proceedings.

DRAFT**Revised Standard—Insolvency of Enterprise Groups*****World Bank Principle C16****C. 16. Insolvency of Domestic Enterprise Groups**

C. 16. 1. Procedural Coordination. The system should specify that the administration of insolvency proceedings with respect to two or more enterprise group members may be coordinated for procedural purposes. The scope and extent of the procedural coordination should be specified by the court.

C. 16. 2. Post-commencement Finance. The system should permit an enterprise group member subject to insolvency proceedings to provide or facilitate post-commencement finance or other kind of financial assistance to other enterprises in the group which are also subject to insolvency proceedings. The system should specify the priority accorded to such post-commencement finance.

C. 16. 3. Substantive Consolidation. The insolvency system should respect the separate legal identity of each of the enterprise group members. When substantive consolidation is contemplated, it should be restricted to circumstances where: (i) assets or liabilities of the enterprise group members are intermingled to such an extent that the ownership of assets and responsibility for liabilities cannot be identified without disproportionate expense or delay; or (ii) the enterprise group members are engaged in a fraudulent scheme or activity with no legitimate business purpose. The court should be able to exclude specific claims and assets from an order of consolidation. In the event of substantive consolidation, the system should contemplate an adequate treatment of secured transactions, priorities, creditor meetings, and avoidance actions. The system should specify that a substantive consolidation order would cause the assets and liabilities of the consolidated enterprises to be treated as if they were part of a single estate; extinguish debts and claims as amongst the relevant enterprises; and cause claims against the relevant enterprises to be treated as if they were against a single insolvency estate.

C. 16. 4. Avoidance actions⁸⁰. The system should authorise the court considering whether to set aside a transaction that took place among enterprise group members, or between any of them and a related person, to take into account the specific circumstances of the transaction.

*This document incorporates two new principles (C16 and C17) to the World Bank Principles for Effective Insolvency and Creditor Rights Systems, the Recommendations contained in Part III of the UNCITRAL Legislative Guide on Insolvency Law. The document should be integrated in the Unified Standard.

⁸⁰ See Principle C11.

C. 16. 5. Insolvency Representative. The system should permit a single or the same insolvency representative to be appointed with respect to two or more enterprise group members, and should include provisions addressing situations involving conflicts of interest. Where there are different insolvency representatives for different enterprise group members, the system should allow insolvency representatives to communicate directly and to cooperate to the maximum extent possible.

C. 16. 6. Reorganization Plans. The system should permit coordinated reorganization plans to be proposed in insolvency proceedings with respect to two or more enterprise group members. The system should allow enterprise group members not subject to insolvency proceedings to voluntarily participate in a reorganization plan of other group members subject to insolvency proceedings.

***UNCITRAL Legislative Guide on insolvency law
Part three: Treatment of enterprise groups in insolvency***

Recommendations

A. Domestic issues

1. Joint application for commencement

Recommendations 199-201

Purpose of legislative provisions

The purpose of provisions on joint application⁸¹ for commencement of insolvency proceedings with respect to two or more enterprise group members is:

- (a) To facilitate coordinated consideration of an application for commencement of insolvency proceedings with respect to those enterprise group members;
- (b) To enable the court to obtain information concerning the enterprise group that would facilitate determination of whether commencement of insolvency proceedings with respect to those group members should be ordered;
- (c) To promote efficiency and reduce costs; and
- (d) To provide a mechanism⁸² for the court to assess whether procedural coordination of those insolvency proceedings would be appropriate.

Contents of legislative provisions

⁸¹ A joint application for commencement does not affect the legal identity of each group member included in the application; each member remains separate and distinct.

⁸² A joint application is not a prerequisite for procedural coordination, but may facilitate the court's consideration of whether an order for procedural coordination should be made.

Joint application for commencement of insolvency proceedings (paras. 8-9)

199. The insolvency law may specify that a joint application for commencement of insolvency proceedings may be made with respect to two or more enterprise group members, each of which satisfies the applicable commencement standard.⁸³

Persons permitted to apply (para. 16)

200. Where the insolvency law provides for joint applications in accordance with recommendation 199, the insolvency law should specify that a joint application may be made by:

- (a) Two or more enterprise group members, each of which satisfies the applicable commencement standard in recommendation 15; or
- (b) A creditor, provided that:
 - (i) It is a creditor of each group member to be included in the application; and
 - (ii) Each of those group members satisfies the commencement standard in recommendation 16.

Competent courts (paras. 17-20)

201. For the purposes of recommendation 13, the words “commencement and conduct of insolvency proceedings, including matters arising in the course of those proceedings” include a joint application for commencement of insolvency proceedings with respect to two or more enterprise group members.⁸⁴

2. Procedural coordination**Recommendations 202-210****Purpose of legislative provisions**

The purpose of provisions on procedural coordination of insolvency proceedings with respect to two or more enterprise group members is:

- (a) To facilitate coordination of the administration of those insolvency proceedings, while respecting the separate legal identity of each group member; and
- (b) To promote cost-efficiency and a better return to creditors.

Contents of legislative provisions*Procedural coordination of two or more insolvency proceedings (paras. 22-25)*

202. The insolvency law should specify that the administration of insolvency proceedings with respect to two or more enterprise group members may be coordinated for procedural purposes.

⁸³ See above, recommendation 15, which addresses debtor applications and recommendation 16, which addresses creditor applications for commencement.

⁸⁴ Recommendation 13 provides: The insolvency law should clearly indicate (or include a reference to the relevant law that establishes) the court that has jurisdiction over the commencement and conduct of insolvency proceedings, including matters arising in the course of those proceedings. The criteria that might be relevant to determining the competent court are discussed in the commentary, see above, para. 18.

203. The insolvency law should specify that, at the request of a person permitted to make an application under recommendation 206 or on its own initiative, the court⁸⁵ may order procedural coordination.

204. Procedural coordination may involve, for example, appointment of a single or the same insolvency representative; establishment of a single creditor committee; cooperation between the courts, including coordination of hearings; cooperation between insolvency representatives, including information sharing and coordination of negotiations; joint provision of notice; coordination between creditor committees; coordination of procedures for submission and verification of claims; and coordination of avoidance proceedings. The scope and extent of the procedural coordination should be specified by the court.

Application for procedural coordination

—Timing of application (paras. 27-28)

205. The insolvency law should specify that an application for procedural coordination may be made at the same time as an application for commencement of insolvency proceedings or at any subsequent time.⁸⁶

—Persons permitted to apply (paras. 29-30)

206. The insolvency law should specify that an application for procedural coordination may be made by:

- (a) An enterprise group member that is subject to an application for commencement of insolvency proceedings or subject to insolvency proceedings;
- (b) The insolvency representative of an enterprise group member; or
- (c) A creditor⁸⁷ of an enterprise group member that is subject to an application for commencement of insolvency proceedings or subject to insolvency proceedings.

3. *Post-commencement finance*

Recommendations 211-216

Purpose of legislative provisions

The purpose of provisions on post-commencement finance in the context of enterprise groups is:

- (a) To facilitate finance to be obtained by enterprise group members subject to insolvency proceedings for the continued operation or survival of their business or the preservation or enhancement of the value of their assets;
- (b) To facilitate the provision of finance by enterprise group members, including group members subject to insolvency proceedings;

⁸⁵ Coordination might involve different courts competent with respect to different group members or a single court that is competent with respect to a number of different insolvency proceedings concerning members of the same group. Accordingly, an order for procedural coordination may require action by one or more than one court.

⁸⁶ The possibility of ordering procedural coordination at an advanced stage of the insolvency proceedings is discussed in the commentary; see above, para. 27.

⁸⁷ To be eligible to make an application for procedural coordination, a creditor does not have to be a creditor of all the group members in respect of which it is seeking procedural coordination.

(c) To ensure appropriate protection for the providers and receivers of post-commencement finance and for those parties whose rights may be affected by the provision of that finance; and

(d) To advance the objective of fair apportionment of the benefit and detriment associated with the provision of post-commencement finance among all group members involved.

Contents of legislative provisions

Post-commencement finance provided by a group member subject to insolvency proceedings to another group member subject to insolvency proceedings (paras. 62-67 and 74)

211. The insolvency law should permit an enterprise group member subject to insolvency proceedings to:

(a) Advance post-commencement finance to other enterprise group members subject to insolvency proceedings;

(b) Grant a security interest over its assets for post-commencement finance provided to another enterprise group member subject to insolvency proceedings; and

(c) Provide a guarantee or other assurance of repayment for post-commencement finance provided to another enterprise group member subject to insolvency proceedings.

212. The insolvency law should specify that post-commencement finance may be provided in accordance with recommendation 211, where the insolvency representative of the group member advancing finance, granting a security interest or providing a guarantee or other assurance:

(a) Determines it to be necessary for the continued operation or survival of the business of that enterprise group member or for the preservation or enhancement of the value of its estate; and

(b) Determines that any harm to creditors of that group member will be offset by the benefit to be derived from advancing finance, granting a security interest or providing a guarantee or other assurance.

213. The insolvency law may require the court to authorize or creditors to consent to the advance of finance, grant of a security interest or provision of a guarantee or other assurance in accordance with recommendations 211 and 212.

Post-commencement finance obtained by a group member subject to insolvency proceedings from another group member subject to insolvency proceedings (paras. 64-67)

214. The insolvency law should specify that in accordance with recommendation 63, post-commencement finance may be obtained from an enterprise group member subject to insolvency proceedings by another group member subject to insolvency proceedings where the insolvency representative of the obtaining group member determines it to be necessary for the continued operation or survival of the business of that group member or for the preservation or enhancement of the value of its estate. The insolvency law may require the court to authorize or creditors to consent to the obtaining of that post-commencement finance.

Priority for post-commencement finance (paras. 70-71)

215. The insolvency law should specify the priority that applies to post-commencement finance provided by one enterprise group member subject to insolvency proceedings to another group member subject to insolvency proceedings.

Security for post-commencement finance (paras. 72-73)

216. The insolvency law should specify that recommendations 65, 66 and 67 apply to the granting of a security interest in accordance with recommendation 211 (b).

4. Avoidance proceedings

Recommendations 217-218

Purpose of legislative provisions

The purpose of avoidance provisions as among enterprise group members is to provide, in addition to the considerations set forth in recommendations 87-99, that the insolvency law may:

- (a) Permit the court to take into account that the transaction took place in the context of an enterprise group, and
- (b) Establish the circumstances that may be considered by the court.

Contents of legislative provisions

Avoidable transactions (paras. 79-80)

217. The insolvency law should specify that, in considering whether a transaction of the kind referred to in recommendation 87 (a), (b) or (c) that took place between enterprise group members or between an enterprise group member and other related persons should be avoided, the court may have regard to the circumstances in which the transaction took place. Those circumstances may include: the relationship between the parties to the transaction; the degree of integration between enterprise group members that are parties to the transaction; the purpose of the transaction; whether the transaction contributed to the operations of the group as a whole; and whether the transaction granted advantages to enterprise group members or other related persons that would not normally be granted between unrelated parties.

Elements of avoidance and defences (para. 81)

218. The insolvency law should specify the manner in which the elements referred to in recommendation 97 would apply to avoidance of transactions in the enterprise group context.⁸⁸

5. Substantive consolidation

Recommendations 219-231

Purpose of legislative provisions

The purpose of provisions on substantive consolidation is:

- (a) To provide legislative authority for substantive consolidation, while respecting the basic principle of the separate legal identity of each enterprise group member;

⁸⁸ That is, the elements to be proved in order to avoid a transaction, the burden of proof, specific defences to avoidance and the application of special presumptions.

(b) To specify the very limited circumstances in which the remedy of substantive consolidation may be available in order to ensure transparency and predictability; and

(c) To specify the effect of an order for substantive consolidation, including the treatment of security interests.

Contents of legislative provisions

The principle of separate legal identity (para. 105)

219. The insolvency law should respect the separate legal identity of each enterprise group member. Exceptions to that general principle should be limited to the grounds set forth in recommendation 220.

Circumstances in which substantive consolidation may be available (paras. 106, 112-114)

220. The insolvency law may specify that, at the request of a person permitted to make an application under recommendation 223, the court may order substantive consolidation with respect to two or more enterprise group members only in the following limited circumstances:

(a) Where the court is satisfied that the assets or liabilities of the enterprise group members are intermingled to such an extent that the ownership of assets and responsibility for liabilities cannot be identified without disproportionate expense or delay; or

(b) Where the court is satisfied that the enterprise group members are engaged in a fraudulent scheme or activity with no legitimate business purpose and that substantive consolidation is essential to rectify that scheme or activity.

Exclusions from substantive consolidation (paras. 135-136)

221. Where the insolvency law provides for substantive consolidation in accordance with recommendation 220, the insolvency law should permit the court to exclude specified assets and claims from an order for substantive consolidation and specify the circumstances in which those exclusions might be ordered.

Application for substantive consolidation

—Timing of application (paras. 117-118)

222. The insolvency law should specify that an application for substantive consolidation may be made at the same time as an application for commencement of insolvency proceedings with respect to enterprise group members or at any subsequent time.⁸⁹

—Persons permitted to apply (paras. 115-116)

223. The insolvency law should specify the persons permitted to make an application for substantive consolidation, which may include an enterprise group member and a creditor or the insolvency representative of any such enterprise group member.

Effect of an order for substantive consolidation (129-133)

224. The insolvency law should specify that an order for substantive consolidation has the following effects:⁹⁰

⁸⁹ The possibility of ordering substantive consolidation at an advanced stage of the insolvency proceedings is discussed in the commentary, see above, paras. 117-118.

⁹⁰ The effect on security interests is addressed in recommendation 225 and paras. 121-124.

- (a) The assets and liabilities of the substantively consolidated group members are treated as if they were part of a single insolvency estate;
- (b) Claims and debts between group members included in the order are extinguished; and
- (c) Claims against group members included in the order are treated as if they were claims against the single insolvency estate.

Treatment of security interests in substantive consolidation (paras. 121-124)

225. The insolvency law should specify that the rights and priorities of a creditor holding a security interest over an asset of an enterprise group member subject to an order for substantive consolidation should, as far as possible, be respected in substantive consolidation, unless:

- (a) The secured indebtedness is owed solely between enterprise group members and is extinguished by an order for substantive consolidation;
- (b) It is determined that the security interest was obtained by fraud in which the creditor participated; or
- (c) The transaction granting the security interest is subject to avoidance in accordance with recommendations 87, 88 and 217.

Recognition of priorities in substantive consolidation (para. 125)

226. The insolvency law should specify that the priorities established under insolvency law and applicable with respect to an individual enterprise group member prior to an order for substantive consolidation should, as far as possible, be recognized in substantive consolidation.

Meetings of creditors (para. 132)

227. The insolvency law should specify that, to the extent a meeting of creditors is required by the law to be held subsequent to an order for substantive consolidation, creditors of all consolidated group members are eligible to attend.

Calculation of the suspect period in substantive consolidation (paras. 130-131)

228. (1) The insolvency law should specify the date from which the suspect period with respect to avoidance of transactions of the type referred to in recommendation 87 should be calculated when substantive consolidation is ordered with respect to two or more enterprise group members.

(2) The specified date from which the suspect period is calculated retrospectively in accordance with recommendation 89 may be:

- (a) A different date for each enterprise group member included in the substantive consolidation, being either the date of application for or commencement of insolvency proceedings with respect to each such group member; or
- (b) A common date for all enterprise group members included in the substantive consolidation, being either (i) the earliest of the dates of application for, or commencement of, insolvency proceedings with respect to those group members; or (ii) the date on which all applications for commencement were made or all proceedings commenced.

Modification of an order for substantive consolidation (para. 134)

229. The insolvency law should specify that an order for substantive consolidation may be modified, provided that any actions or decisions already taken pursuant to the order are not affected by the modification.⁹¹

Competent court (para. 137)

230. For the purposes of recommendation 13, the words “commencement and conduct of insolvency proceedings, including matters arising in the course of those proceedings” include an application or order for substantive consolidation, including modification of that order.⁹²

Notice of substantive consolidation (paras. 126-128)

231. The insolvency law should establish requirements for giving notice with respect to applications and orders for substantive consolidation and for modification of substantive consolidation, including the scope and extent of the order; the parties to whom notice should be given; the party responsible for giving notice; and the content of the notice.

6. *Appointment of the insolvency representative*

Recommendations 232-236

Purpose of legislative provisions

The purpose of provisions on appointment of insolvency representatives in an enterprise group context is:

(a) To permit appointment of a single or the same insolvency representative to facilitate coordination of insolvency proceedings commenced with respect to two or more enterprise group members; and

(b) To encourage cooperation where two or more insolvency representatives are appointed, with a view to avoiding duplication of effort; facilitating gathering of information on the financial and business affairs of the enterprise group as a whole; and reducing costs.

Contents of legislative provisions

Appointment of a single or the same insolvency representative (paras. 142-144)

232. The insolvency law should specify that, where it is determined to be in the best interests of the administration of the insolvency proceedings with respect to two or more enterprise group members, a single or the same insolvency representative may be appointed to administer those proceedings.⁹³

Conflict of interest (para. 144 and part two, chap. III, paras. 42-43)

233. The insolvency law should specify measures to address any conflict of interest that might arise when a single or the same insolvency representative is appointed to administer insolvency proceedings with respect to two or more enterprise group members. Such measures may include the appointment of one or more additional insolvency representatives.

⁹¹ It is not intended that use of the term “modification” would include termination of an order for substantive consolidation.

⁹² The criteria that might be relevant to determining the competent court are discussed above, para. 18.

⁹³ Although recommendation 118 addresses selection and appointment of the insolvency representative, it does not recommend appointment by any particular authority, but leaves it up to the insolvency law. The same approach would apply in the enterprise group context.

Cooperation between two or more insolvency representatives (paras. 139-140)

234. The insolvency law may specify that when different insolvency representatives are appointed to administer insolvency proceedings with respect to two or more enterprise group members, those insolvency representatives should cooperate with each other to the maximum extent possible.⁹⁴

Cooperation between two or more insolvency representatives in procedural coordination (paras. 139-140)

235. The insolvency law should specify that, when more than one insolvency representative is appointed to administer insolvency proceedings that are subject to procedural coordination, those insolvency representatives should cooperate with each other to the maximum extent possible.

Cooperation to the maximum extent possible between insolvency representatives (paras. 139-140)

236. The insolvency law should specify that the cooperation to the maximum extent possible between insolvency representatives be implemented by any appropriate means, including:

(a) Sharing and disclosure of information concerning the enterprise group members subject to insolvency proceedings, provided appropriate arrangements are made to protect confidential information;

(b) Approval or implementation of agreements with respect to allocation of responsibilities between insolvency representatives, including one insolvency representative taking a coordinating role;

(c) Coordination of the administration and supervision of the affairs of the group members subject to insolvency proceedings, including day-to-day operations where the business is to be continued; post-commencement finance; safeguarding of assets; use and disposition of assets; exercise of avoidance powers; communication with creditors and meetings of creditors; submission and admission of claims, including intra-group claims; and distributions to creditors; and

(d) Coordination with respect to the proposal and negotiation of reorganization plans.

7. Reorganization plans**Recommendations 237-238****Purpose of legislative provisions**

The purpose of provisions relating to reorganization plans in an enterprise group context is:

(a) To facilitate the coordinated reorganization of the businesses of enterprise group members subject to the insolvency law, thereby preserving employment and, in appropriate cases, protecting investment; and

⁹⁴ In addition to the provisions of the insolvency law with respect to cooperation and coordination, the court generally may indicate measures to be taken to that end in the course of administration of the proceedings.

(b) To facilitate the negotiation and proposal of coordinated reorganization plans in insolvency proceedings with respect to two or more enterprise group members.

Contents of legislative provisions

Coordinated reorganization plans (paras. 147-151)

237. The insolvency law should permit coordinated reorganization plans to be proposed in insolvency proceedings with respect to two or more enterprise group members.

Including a solvent group member in a reorganization plan for an insolvent group member (para. 152)

238. The insolvency law should specify that an enterprise group member that is not subject to insolvency proceedings may voluntarily participate in a reorganization plan proposed for one or more enterprise group members subject to insolvency proceedings

World Bank Principle C17

C. 17. Insolvency of International Enterprise Groups⁹⁵

C. 17. 1. Access to court and Recognition of Proceedings. In the context of the insolvency of enterprise group members, the system should provide foreign representatives and creditors with access to the court, and for the recognition of foreign insolvency proceedings, if necessary.

C. 17. 2. Cooperation involving courts. The system should allow the national court to cooperate to the maximum possible extent with foreign courts or foreign representatives, either directly or through the local insolvency representative. The system should permit the national court to communicate directly with, or to request information or assistance directly from, foreign courts or representatives.

C. 17. 3. Cooperation involving insolvency representatives. The system should allow insolvency representatives appointed to administer proceedings with respect to an enterprise group member to communicate directly and to cooperate to the maximum extent possible with foreign courts and with foreign insolvency representatives in order to facilitate coordination of the proceedings.

C. 17. 4. Appointment of the insolvency representative. The system should allow, in specific circumstances, for the appointment of a single or the same insolvency representative for enterprise group members in different States. In such cases, the system should include measures addressing situations involving conflicts of interest.

C. 17. 5. Cross-border insolvency agreements. The system should permit insolvency representatives and other parties in interest to enter into cross-border insolvency agreements involving two or more enterprise group members in different States in order to facilitate coordination of the proceedings. The system should allow the courts to approve or implement such agreements.

⁹⁵ See Principle C15. See also Principle C16.

***UNCITRAL Legislative Guide on insolvency law
Part three: Treatment of enterprise groups in insolvency***

Recommendations

B. International issues

1. Access and recognition

Recommendation 239

Purpose of legislative provisions

The purpose of provisions on access to courts and recognition of foreign insolvency proceedings with respect to enterprise group members is to ensure that, access and recognition are available under applicable law.

Contents of legislative provisions

Access to courts and recognition of foreign proceedings

239. The insolvency law should provide, in the context of insolvency proceedings with respect to enterprise group members,

- (a) Access to the courts for foreign representatives and creditors; and
- (b) Recognition of the foreign proceedings, if necessary under applicable law.

2. Cooperation involving the courts

Recommendations 240-245

Purpose of legislative provisions

The purpose of legislative provisions on cooperation involving courts in the context of multinational enterprise groups is:

- (a) To authorize and facilitate cooperation between the courts seized of insolvency proceedings relating to different members of an enterprise group in different States;
- (b) To authorize and facilitate cooperation between the courts and the insolvency representatives appointed to administer those different proceedings; and
- (c) To facilitate and promote the use of various forms of cooperation to coordinate insolvency proceedings with respect to different enterprise group members in different States and establish the conditions and safeguards that should apply to those forms of cooperation to protect the substantive and procedural rights of parties and the authority and independence of the courts.

Contents of legislative provisions⁹⁶*Cooperation between the court and foreign courts or foreign representatives (paras. 14 and 37)*

240. The insolvency law should permit the court that is competent with respect to insolvency proceedings concerning an enterprise group member to cooperate to the maximum extent possible with foreign courts or foreign representatives,⁹⁷ either directly or through the insolvency representative or other person appointed to act at the direction of the court, to facilitate coordination of those proceedings and insolvency proceedings commenced in other States with respect to members of the same enterprise group.

Cooperation to the maximum extent possible involving courts (para. 14)

241. The insolvency law should specify that cooperation to the maximum extent possible between the court and foreign courts or foreign representatives be implemented by any appropriate means, including for example:

- (a) Communication of information by any means considered appropriate by the court, including provision to the foreign court or the foreign representative of copies of documents issued by the court or that have been or are to be filed with the court concerning the enterprise group members subject to insolvency proceedings or participation in communications with the foreign court or foreign representative;
- (b) Coordination of the administration and supervision of the affairs of the enterprise group members subject to insolvency proceedings;
- (c) Appointment of a person or body to act at the direction of the court; and
- (d) Approval or implementation of agreements concerning coordination of insolvency proceedings in accordance with recommendation 254.

Direct communication between the court and foreign courts or foreign representatives⁹⁸ (paras. 15-20)

242. The insolvency law should permit the court that is competent with respect to insolvency proceedings concerning an enterprise group member to communicate directly with, or to request information or assistance directly from, foreign courts or foreign representatives concerning those proceedings and insolvency proceedings commenced in other States with respect to members of the same enterprise group to facilitate coordination of those proceedings.

Conditions applicable to cross-border communication involving courts (paras. 21-33)

243. The insolvency law should specify that communication between the courts and between courts and foreign representatives should be subject to the following conditions:

- (a) The time, place and manner of communication should be determined between the courts or between the courts and foreign representatives;
- (b) Notice of any proposed communication should be provided to parties in interest in accordance with applicable law;

⁹⁶ These recommendations on cooperation are intended to be permissive, not directive and are consistent with the corresponding articles of the Model Law, articles 25.1 and 26.1.

⁹⁷ Defined in article 2(d) of the Model Law to mean “a person or body, including one appointed on an interim basis, authorized on a foreign proceeding to administer the reorganization or the liquidation of the debtor’s assets or affairs or to act as a representative of the foreign proceeding.”

⁹⁸ See UNCITRAL Model Law, articles 25.2 and 26.2.

(c) An insolvency representative should be entitled to participate in person in a communication. A party in interest may participate in a communication in accordance with applicable law and when determined by the court to be appropriate;

(d) The communication may be recorded and a written transcript prepared as directed by the courts. That transcript may be treated as an official transcript of the communication and filed as part of the record of the proceedings;

(e) Communications should only be treated as confidential in exceptional cases to the extent considered appropriate by the courts and in accordance with applicable law; and

(f) Communication should respect the mandatory rules of the jurisdictions involved in the communication, as well as the substantive and procedural rights of parties in interest, in particular the confidentiality of information.

Effect of communication (para. 34)

244. The insolvency law should specify that communication involving the courts shall not imply:

- (a) A compromise or waiver by the court of any powers, responsibilities or authority;
 - (b) A substantive determination of any matter before the court;
 - (c) A waiver by any of the parties of any of their substantive or procedural rights;
- or
- (d) A diminution of the effect of any of the orders made by the court.

Coordination of hearings (paras. 38-40)

245. The insolvency law may permit the court to conduct a hearing in coordination with a foreign court. Where hearings are coordinated, they may be subject to certain conditions to safeguard the substantive and procedural rights of parties and the jurisdiction of each court. Those conditions might address the rules applicable to the conduct of the hearing; the requirements for the provision of notice; the method of communication to be used; the conditions applicable to the right to appear and be heard; the manner of submission of documents to the court and their availability to a foreign court; and limitation of the jurisdiction of each court to the parties appearing before it.⁹⁹ Notwithstanding the coordination of hearings, each court remains responsible for reaching its own decision on the matters before it.

3. *Cooperation involving insolvency representatives*

Recommendations 246-250

Purpose of legislative provisions

The purpose of legislative provisions on cooperation between insolvency representatives and between insolvency representatives and foreign courts in the context of multinational enterprise groups is:

- (a) To authorize and facilitate cooperation between insolvency representatives appointed to administer insolvency proceedings relating to different members of an enterprise group in different States and between those representatives and foreign courts; and

⁹⁹ See also UNCITRAL Model Law, article 10.

(b) To facilitate and promote the use of various forms of cooperation between those insolvency representatives and between them and foreign courts and establish the conditions and safeguards that should apply to those forms of cooperation to protect the substantive and procedural rights of parties in interest.

Contents of legislative provisions

Cooperation between the insolvency representative and foreign courts

246. The insolvency law should permit the insolvency representative appointed to administer insolvency proceedings with respect to an enterprise group member, in the exercise of its functions and subject to the supervision of the court, to cooperate to the maximum extent possible with foreign courts to facilitate coordination of those proceedings and insolvency proceedings commenced in other States with respect to members of the same enterprise group.

Cooperation between insolvency representatives

247. The insolvency law should permit the insolvency representative appointed to administer insolvency proceedings with respect to an enterprise group member, in the exercise of its functions and subject to the supervision of the court, to cooperate to the maximum extent possible with foreign representatives¹⁰⁰ appointed to administer insolvency proceedings commenced in other States with respect to members of the same enterprise group to facilitate coordination of those proceedings.

Direct communication between the insolvency representative and foreign courts

248. The insolvency law should permit an insolvency representative appointed to administer insolvency proceedings with respect to an enterprise group member, in the exercise of its functions and subject to the supervision of the court, to communicate directly with or to request information or assistance directly from foreign courts concerning those proceedings and insolvency proceedings commenced in other States with respect to members of the same enterprise group to facilitate coordination of those proceedings.

Direct communication between insolvency representatives

249. The insolvency law should permit an insolvency representative appointed to administer insolvency proceedings with respect to an enterprise group member, in the exercise of its functions and subject to the supervision of the court, to communicate directly with foreign representatives appointed to administer insolvency proceedings commenced in other States with respect to members of the same enterprise group concerning those proceedings to facilitate coordination of those proceedings.

Cooperation to the maximum extent possible between insolvency representatives

250. The insolvency law should specify that cooperation to the maximum extent possible between insolvency representatives be implemented by any appropriate means, including:

(a) Sharing and disclosure of information concerning the enterprise group members subject to insolvency proceedings, provided appropriate arrangements are made to protect confidential information;

¹⁰⁰ See footnote to recommendation 240 (article 2(d) of the UNCITRAL Model Law) with respect to the definition of a foreign representative, which would include an insolvency representative appointed on an interim basis.

(b) Use of cross-border insolvency agreements in accordance with recommendation 253;¹⁰¹

(c) Allocation of responsibilities between insolvency representatives, including one insolvency representative taking a coordinating role;

(d) Coordination of the administration and supervision of the affairs of the enterprise group members subject to insolvency proceedings, including day-to-day operations where the business is to be continued; post-commencement finance; safeguarding of assets; use and disposition of assets; exercise of avoidance powers; communication with creditors and meetings of creditors; submission and admission of claims, including intra-group claims; and distributions to creditors; and

(e) Coordination with respect to proposal and negotiation of reorganization plans.

4. *Appointment of the insolvency representative*

Recommendations 251-252

Purpose of legislative provisions

The purpose of legislative provisions on appointment of the insolvency representative in the context of multinational enterprise groups is, in the interests of promoting efficient and effective administration of insolvency proceedings with respect to members of the same enterprise group in different States,

(a) To authorize, where the court determines it to be in the best interests of the relevant insolvency proceedings, the appointment of a single or the same insolvency representative to administer multiple proceedings; and

(b) To address any conflicts of interest that might arise where a single or the same insolvency representative is appointed.

Contents of legislative provisions

Appointment of a single or the same insolvency representative (paras. 43-46)

251. The insolvency law should permit the court, in appropriate cases, to coordinate with foreign courts with respect to the appointment of a single or the same insolvency representative to administer insolvency proceedings concerning members of the same enterprise group in different States, provided that the insolvency representative is qualified to be appointed in each of the relevant States. To the extent required by applicable law, the insolvency representative would be subject to the supervision of each of the appointing courts.

Conflict of interest (para. 47)

252. The insolvency law should specify measures to address any conflict of interest that might arise when a single or the same insolvency representative is appointed to administer insolvency proceedings with respect to two or more enterprise group members in different States. Such measures may include the appointment of one or more additional insolvency representatives.

¹⁰¹ The UNCITRAL Practice Guide compiles practice with respect to the use and negotiation of these agreements, including a discussion of the issues typically addressed.

5. Cross-border insolvency agreements

Recommendations 253-254

Purpose of legislative provisions

The purpose of legislative provisions with respect to cross-border insolvency agreements is to ensure that the insolvency law:

(a) Permits the use of such agreements to facilitate cooperation with respect to insolvency proceedings in different States concerning members of the same enterprise group; and

(b) Authorizes the approval of such agreements by the court, as appropriate.

Contents of legislative provisions

Authority to enter into cross-border insolvency agreements (paras. 48, 50, 53-54)

253. The insolvency law should permit the insolvency representative and other parties in interest to enter into a cross-border insolvency agreement involving two or more members of an enterprise group in different States to facilitate coordination of insolvency proceedings with respect to those group members.

Approval or implementation of cross-border insolvency agreements (paras. 53-54)

254. The insolvency law should permit the court to approve or implement a cross-border insolvency agreement involving two or more members of an enterprise group in different States to facilitate coordination of the insolvency proceedings with respect to those enterprise group members.

D. IMPLEMENTATION: INSTITUTIONAL & REGULATORY FRAMEWORKS**1. ROLE OF COURTS****World Bank Principle****Role of Courts [D1]**

- D1.1 Independence, Impartiality and Effectiveness.** The system should guarantee the independence of the judiciary. Judicial decisions should be impartial. Courts should act in a competent manner and effectively.
- D1.2 Role of Courts in Insolvency Proceedings.** Insolvency proceedings should be overseen and impartially disposed of by an independent court and assigned, where practical, to judges with specialized insolvency expertise. Nonjudicial institutions playing judicial roles in insolvency proceedings should be subject to the same principles and standards applied to the judiciary.
- D1.3 Jurisdiction of the Insolvency Court.** The court's jurisdiction should be defined and clear with respect to insolvency proceedings and matters arising in the conduct of these proceedings.
- D1.4 Exercise of Judgment by the Court in Insolvency Proceedings.** The court should have sufficient supervisory powers to efficiently render decisions in proceedings in line with the legislation without inappropriately assuming a governance or business management role for the debtor, which would typically be assigned to management or an insolvency representative.
- D1.5 Role of Courts in Commercial Enforcement Proceedings.** The general court system must include components that effectively enforce the rights of both secured and unsecured creditors outside of insolvency proceedings. If possible, these components should be staffed by specialists in commercial matters. Alternatively, specialized administrative agencies with that expertise may be established.

UNCITRAL Recommendations**Competent courts** (part two, chap. I, para. 19)

13. The insolvency law should clearly indicate (or include a reference to the relevant law that establishes) the court that has jurisdiction over the commencement and conduct of insolvency proceedings, including matters arising in the course of those proceedings.

2. JUDICIAL SELECTION, QUALIFICATION, TRAINING AND PERFORMANCE**World Bank Principle****Judicial Selection, Qualification, Training and Performance [D2]**

- D2.1 Judicial Selection and Appointment.** Adequate and objective criteria should govern the process for selection and appointment of judges.
- D2.2 Judicial Training.** Judicial education and training should be provided to judges.
- D2.3 Judicial Performance.** Procedures should be adopted to ensure the competence of the judiciary and efficiency in the performance of court proceedings. These procedures serve as a basis for evaluating court efficiency and for improving the administration of the process.

3. COURT ORGANIZATION

World Bank Principle

Court Organization [D3]

The court should be organized so that all interested parties—including the attorneys, the insolvency representative, the debtor, the creditors, the public, and the media—are dealt with fairly, in a timely manner, objectively, and as part of an efficient, transparent system. Implicit in that structure are firm and recognized lines of authority, clear allocation of tasks and responsibilities, and orderly operations in the courtroom and case management.

4. TRANSPARENCY AND ACCOUNTABILITY

World Bank Principle

Transparency and Accountability [D4]

An insolvency and creditor rights system should be based upon transparency and accountability. Rules should ensure ready access to relevant court records, court hearings, debtor and financial data, and other public information.

5. JUDICIAL DECISION MAKING AND ENFORCEMENT OF ORDERS

World Bank Principle

Judicial Decision Making and Enforcement Of Orders [D5]

- D5.1 Judicial Decision Making.** Judicial decision making should encourage consensual resolution among parties where possible, and should otherwise undertake timely adjudication of issues with a view to reinforcing predictability in the system through consistent application of the law.
- D5.2 Enforcement of Orders.** The court must have clear authority and effective methods of enforcing its judgments.
- D5.3 Creating a Body of Jurisprudence.** A body of jurisprudence should be developed by means of consistent publication of important and novel judicial decisions, especially by higher courts, using publication methods that are both conventional and electronic (where possible).

6. INTEGRITY OF THE SYSTEM**World Bank Principle****Integrity of the System [D6]**

- D6.1 Integrity of the court.** The system should guarantee security of tenure and adequate remuneration of judges, personal security for judicial officers, and the security of court buildings. Court operations and decisions should be based on firm rules and regulations to avoid corruption and undue influence.
- D6.2 Conflict of interest and bias.** The court must be free of conflicts of interest, bias, and lapses in judicial ethics, objectivity, and impartiality.
- D6.3 Integrity of participants.** Persons involved in a proceeding must be subject to rules and court orders designed to prevent fraud, other illegal activity, and abuse of the insolvency and creditor rights system. In addition, the court must be vested with appropriate powers to enforce its orders and address matters of improper or illegal activity by parties or persons appearing before the court with respect to court proceedings.

7. ROLE OF REGULATORY OR SUPERVISORY BODIES**World Bank Principle****Role of Regulatory or Supervisory Bodies [D7]**

The bodies responsible for regulating or supervising insolvency representatives should:

- Be independent of individual representatives;
- Set standards that reflect the requirements of the legislation and public expectations of fairness, impartiality, transparency, and accountability; and,
- Have appropriate powers and resources to enable them to discharge their functions, duties, and responsibilities effectively.

8. COMPETENCE AND INTEGRITY OF INSOLVENCY ADMINISTRATORS**World Bank Principle****Competence and Integrity of Insolvency Administrators [D8]**

The system should ensure that:

- Criteria as to who may be an insolvency representative should be objective, clearly established, and publicly available;
- Insolvency representatives be competent to undertake the work to which they are appointed and to exercise the powers given to them;
- Insolvency representatives act with integrity, impartiality, and independence; and
- Insolvency representatives, where acting as managers, be held to director and officer standards of accountability, and be subject to removal for incompetence, negligence, fraud, or other wrongful conduct.¹⁰²

UNCITRAL Recommendations

The insolvency representative (part two, chap. III, paras. 35-74)

¹⁰² See Principle B2.

Purpose of legislative provisions

The purpose of provisions concerning the insolvency representative is:

- (a) To specify qualifications required for appointment;
- (b) To establish a mechanism for selection and appointment;
- (c) To specify powers and functions; and
- (d) To provide for remuneration, liability, removal and replacement.

Contents of legislative provisions**Qualifications**

115. The insolvency law should specify the qualifications and qualities required for appointment as an insolvency representative, including integrity, independence, impartiality, requisite knowledge of relevant commercial law and experience in commercial and business matters. The insolvency law should also specify the grounds upon which a proposed insolvency representative may be disqualified from appointment.

Conflict of interest

116. The insolvency law should require the disclosure of a conflict of interest, a lack of independence or circumstances that may lead to a conflict of interest or lack of independence by:

- (a) A person proposed for appointment as an insolvency representative or a person appointed as an insolvency representative where the conflict of interest or the circumstances that may lead to a conflict of interest or lack of independence arise in the course of insolvency proceedings; and
- (b) Persons proposed for employment by the insolvency representative or the estate, including professionals or a person employed by the insolvency representative or the estate, where the conflict of interest or the circumstances that may lead to a conflict of interest or lack of independence arise in the course of insolvency proceedings.

117. The insolvency law should specify that the obligation to disclose set forth in recommendation 116 should continue throughout the insolvency proceedings. The insolvency law should specify the consequences of a conflict of interest or lack of independence.

Appointment

118. The insolvency law should establish a mechanism for selection and appointment of an insolvency representative. Different approaches may be taken, including appointment by the court; by an independent appointing authority; on the basis of a recommendation by creditors or the creditor committee; by the debtor; or by operation of insolvency law, where the insolvency representative is a government or administrative agency or official.

Remuneration

119. The insolvency law should establish a mechanism for fixing the remuneration of the insolvency representative and establish priority for payment of that remuneration.

Duties and Functions Of The Insolvency Representative

120. The insolvency law should specify that the insolvency representative have an obligation to protect and preserve the assets of the estate. The insolvency law should specify the insolvency representative's duties and functions with respect to the administration of the proceedings and preservation and protection of the estate, including continued operation of the debtor's business.

Right to be heard

See recommendation 137.

Confidentiality

See recommendation 111.

Liability

121. The insolvency law should specify the consequences of the insolvency representative's failure to perform, or to properly perform, its duties and functions under the law and any related

standard of liability imposed.

Removal and replacement

122. The insolvency law should establish the grounds and procedure for removal of the insolvency representative. The grounds may include:

- (a) Incompetence, failure to perform or failure to exercise the proper degree of care in the performance of its powers and functions;
- (b) Inability to perform;
- (c) Lack of a particular or specialized qualification required by a specific case;
- (d) Engaging in illegal acts or conduct;
- (e) Conflict of interest or a lack of independence that would justify removal; or
- (f) Where the function of the insolvency representative changes.¹⁰³

123. The insolvency law should establish a mechanism for removal of the insolvency representative that reflects the manner in which the insolvency representative was appointed and provides a right for the insolvency representative to be heard.

124. In the event of the death, resignation, or removal of the insolvency representative, the insolvency law should establish a mechanism for appointment of a replacement and specify whether or not court approval of the replacement is necessary.

Estates With Insufficient Assets To Meet The Costs Of Administration

125. Where the insolvency law provides for an insolvency representative to be appointed to administer an estate with insufficient assets to meet the costs of administration, the insolvency law should also establish a mechanism for appointment and remuneration of that representative.

¹⁰³ Such as where the proceedings are converted from liquidation to reorganization.