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Report of the Working Group on Insolvency Law on the work of its twenty-fourth session (New York, 23 July-3 August 2001)

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I. Introduction

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

2. At that session, the Commission also recommended that in carrying out its task the Working Group should be mindful of the work under way or already completed by other organizations, including the World Bank, the International Monetary Fund (IMF), the Asian Development Bank (ADB), INSOL International (INSOL) (an international federation of insolvency professionals) and Committee J of the Section on Business Law of the International Bar Association (IBA). In order to obtain the views and benefit from the expertise of those organizations, it was noted that the Secretariat would organize a colloquium before the next session of the Working Group, in cooperation with INSOL and the IBA, as had been offered by those organizations.[1]

3. That colloquium was organized with the co-sponsorship and organizational assistance of INSOL and in conjunction with the IBA at Vienna, 4-6 December 2000, with a view to identifying and discussing the needs of nations in the process of undertaking reform of their domestic laws relating to insolvency and to determine the manner in which the Commission and other organizations could assist that process of reform.

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

5. At its thirty-fourth session (Vienna, 25 June-13 July 2001), the Commission took note with satisfaction of the report of the Colloquium (A/CN.9/495) and commended the work accomplished so far, particularly the holding of the Colloquium and the efforts of coordination with the work carried out by other international organizations in the area of insolvency law. The Commission discussed the recommendations of the Colloquium, particularly with respect to the form that future work might take and the interpretation of the mandate given to the Working Group by the Commission at its thirty-third session.

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

6. In terms of the mandate given to the Working Group, the Commission was generally of the view that it should be interpreted broadly to enable the Working Group to develop a work product that could reflect the elements mentioned in the mandate for inclusion (see para. 1 above and document A/CN.9/495, para. 13). As to the possible form of future work, it was reaffirmed that a model law on substantive features of an insolvency regime would be neither desirable nor feasible, given the complexity and variety of issues involved in insolvency law and the disparity of approaches taken within the various legal systems. The view was widely shared that the work should ensure as much flexibility as possible, while at the same time maximizing utility. A concern was that while a legislative guide could provide the necessary flexibility, it might result in a product that was too general and too abstract to provide the required guidance. Accordingly, it was suggested that the Working Group bear in mind the need to be as specific as possible in developing its work and in that connection it was suggested that model legislative provisions, even if only addressing some of the issues to be included in the guide, should be included as far as possible.

7. The view was widely shared that the work should take the form of a legislative guide. It was pointed out that a product issued in that form might prove very useful not only for countries that did not have efficient and effective insolvency regimes and needed to develop such a regime, but also for countries which had undertaken or were to undertake the process of modernizing and reviewing their national systems. A further view was that in developing the guide the Working Group should be mindful of the goal of furthering trade and promoting commerce, not just of the goal of harmonization of existing laws.

8. It was suggested that the three key areas for organizing the material to be included in the guide, as outlined in paragraphs 30-33 of document A/CN.9/495, provided an appropriate format for the essential elements and that work should proceed on that basis. As to the substantive contents of the guide, a number of suggestions were made, including that, in developing the legislative guide, the Working Group should bear in mind a number of key principles and objectives such as: respecting issues of public policy; enhancing the coordination role of courts; establishing a special regime for public claims; the priority of reorganization over liquidation; preserving the operation of the business and employment; guaranteeing salaries; the role of courts in controlling the insolvency representatives; equal treatment of creditors; transparency of collective proceedings. It was observed that those principles should not be interpreted as limiting the mandate given to the Working Group, but might usefully be taken into account by the Working Group for the purposes of guidance and to avoid the legislative guide being overly general. It was suggested that either banks and financial institutions should remain outside the scope of the work or that a special regime should be maintained for those entities.

9. Other suggestions which received some support included the need to take account of a number of issues that had proven to be problems in international insolvency, such as the difficulty of collecting and disseminating information on companies that were the subject of insolvency proceedings, providing access for foreign creditors to make claims, equal treatment of foreign creditors and the treatment of late claims, especially where they may be made by foreign creditors. It was further noted that insufficient care in decisions to grant credit proved, though apparently remote, to be one of the causes of insolvency. It was recalled that the UNCITRAL Model Law on Cross-Border Insolvency already addressed a number of those problems. It was noted that while some of those issues might also be relevant in the context of the current project to develop a legislative

guide, there was no intention that the current project should change or amend the Model Law in any way.

10. After discussion, the Commission confirmed that the mandate given to the Working Group at the thirty-third session of the Commission should be widely interpreted to ensure an appropriately flexible work product, which should take the form of a legislative guide.

11. The Working Group on Insolvency Law, which was composed of all States members of the Commission, held its twenty-fourth session at New York from 23 July to 3 August 2001. The session was attended by representatives of the following States members of the Working Group: Austria, Brazil, Cameroon, Canada, Colombia, Fiji, France, Germany, Honduras, India, Iran (Islamic Republic of), Italy, Japan, Lithuania, Russian Federation, Singapore, Spain, Sudan, Sweden, Thailand, Uganda, United Kingdom of Great Britain and Northern Ireland and United States of America.

12. The session was attended by observers from the following States: Algeria, Australia, Bangladesh, Belarus, Brunei Darussalam, Bulgaria, Denmark, Ecuador, Lao People's Democratic Republic, Guinea, New Zealand, Nigeria, Peru, Philippines, Portugal, Republic of Korea, Saudi Arabia, Slovakia, Switzerland, Turkey, United Arab Emirates, Venezuela and Yugoslavia.

13. The session was also attended by observers from the following international organizations: American Bar Association, Asian Development Bank, European Bank for Reconstruction and Development (EBRD), European Central Bank, Groupe de Reflexion sur l'insolvabilité et sa prévention (G.R.I.P.), Insol International, International Bar Association, Inter Pacific Bar Association, International Insolvency Institute, International Monetary Fund, International Working Group on European Insolvency Law, The Group of Thirty, World Association of Former United Nations Interns and Fellows and the World Bank.

14. The Working Group elected the following officers:

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

Vice-Chairman: Mr. Paul HEATH (New Zealand), elected in his personal capacity;

Rapporteur: Mr. Jorge PINZON SANCHEZ (Colombia).

15. The Working Group had before it the following documents: the provisional agenda (A/CN.9/WG.V/WP.53), two Reports of the Secretary-General: "First draft of a legislative guide on insolvency law" (A/CN.9/WG.V/WP.54, A/CN.9/WG.V/WP.54/Add.1 and A/CN.9/WG.V/WP.54/Add.2) and "Alternative approaches to out-of-court insolvency processes" (A/CN.9/WG.V/WP.55).

16. The Working Group adopted the following agenda:

1. Election of officers.

2. Adoption of the agenda.

3. Preparation of a legislative guide on insolvency law.

4. Other business.

5. Adoption of the report.

II. Deliberations and decisions

17. At the present session, the Working Group on Insolvency Law commenced its work on the preparation of a legislative guide on insolvency law, pursuant to the decisions taken by the Commission at its thirty-third (New York, 12 June-7 July 2000)[2] and thirty-fourth sessions (Vienna, 25 June-13 July 2001).[3] The decisions and deliberations of the Working Group with respect to that legislative guide are reflected in section III below.

18. The Secretariat was requested to prepare a revised version of the guide, based on those deliberations and decisions, to be presented to the twenty-fifth session of the Working Group on Insolvency Law (Vienna, 3-14 December 2001) for review and further discussion.

III. Consideration of draft legislative guide on insolvency law

A. General Remarks

19. At the outset of the current session, some international organizations presented the status of their work in the field of insolvency law. The Working Group heard that the World Bank report "Principles and Guidelines for Effective Insolvency and Creditor Rights Systems" had been published in April 2001. In that connection, it was observed that a crucial goal of the report was to foster and enhance the availability of credit by increasing certainty and predictability of creditors' rights, so that they can accurately assess the risks and consequences of the loans they make. While counterbalancing policies might be appropriate in some cases, it was suggested that they should not intrude into the insolvency regime unless a balance could be achieved with the goals of certainty and predictability. It was noted that national surveys aimed at refining the Principles in respect of the specific needs of different jurisdictions would be carried out as a way of implementing the report. The need for devices capable of increasing the availability and reducing the cost of credit was recognized by various international organizations active in the field of insolvency law.

B. Key objectives of an effective and efficient insolvency regime

20. The Working Group commenced its consideration of the draft legislative guide set forth in documents A/CN.9/WG.V/WP.54 and addenda 1 and 2 by considering the statement of key objectives set forth in Part One, paragraphs 16-22. The view was expressed that Part One reflected the key objectives necessary for effective and efficient

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

[3] *Official Records of the General Assembly, Fifty-sixth Session, Supplement No. 18*, A/55/18, paras. ___ (to be finalized yet).

insolvency regimes and that few additions were required. It was suggested that the need to have an insolvency system anchored within both the legal and commercial regimes of a country should be clearly stated within the key objectives, with the reference to commercial systems intended to include not only commercial law but also commercial practices and usages which were recognized as part of a country's regulatory regime. It was also suggested that the key objectives should be developed in parallel with the discussions in the Working Group on the substance of the draft Guide. In particular, it was pointed out that the words in square brackets in paragraph 19, referring to sanctions for failure to commence insolvency proceedings at an early stage, raised issues of substance that would need to be considered in the context of initiation and commencement in Part Two of the draft Guide. Because of the importance to an effective and efficient insolvency regime of provisions addressing cross-border issues, it was suggested that the relationship between the draft Guide and the Model Law on Cross-Border Insolvency should be borne in mind in the discussions, with a view to determining at a later stage whether the Model Law should form part of the final work product.

C. Core provisions of an effective and efficient insolvency regime

1. Relationship between liquidation and reorganization proceedings

21. The general view was that the draft Guide should point out, in a complementary manner, the advantages and disadvantages of the different types of proceedings available in order to ensure flexibility and that the choice of proceedings in any given case was focused upon the most efficient solution. It was agreed that both liquidation and reorganization proceedings should be included as options and that the draft Guide should reflect both unitary proceedings (where the decision as to whether liquidation or reorganization was the most appropriate process was made at some time after the application for commencement when there had been an opportunity to assess what was most appropriate for the enterprise in question) and dual proceedings (where the party commencing the proceedings was given the choice of liquidation or reorganization).

22. While noting that maximization of value was a key objective, it was pointed out that there were cases that should be mentioned in the draft Guide where that objective should be balanced against more important social interests that might suggest the adoption of a different approach. It was suggested that the draft Guide should point out the implications of the choice of unitary or dual processes in terms of other components of the insolvency regime, rather than recommending the adoption of one or the other approach. For example, where dual proceedings were adopted, the insolvency regime should provide for conversion between them and the draft Guide should indicate the circumstances in which that conversion would be most likely to be relevant, such as in reorganization proceedings commenced by the debtor or by the creditors and liquidation proceedings commenced by the creditors. While it was suggested that it might also be appropriate for the draft Guide to consider which party could seek conversion, whether based upon an approach that reflected the interests of creditors or balanced the interests of all stakeholders, some concern was expressed that that involved matters that should be left to national law. Where a unitary proceeding was preferred, it was suggested there would need to be a period of assessment protected by a stay, in order to allow the entity to stabilize its situation and determine the most efficient ways of addressing its financial difficulties.

2. Initiation and commencement of insolvency proceedings

(a) Scope

23. One concern expressed related to the reference in paragraph 24 to presence of assets as a basis for commencement of insolvency proceedings. It was suggested that while that connection might be a sufficient basis for the commencement of liquidation proceedings, it was too tenuous for the commencement of reorganization proceedings. A further concern related to the inclusion within the insolvency regime of state-owned enterprises, whether acting in a commercial capacity or not.

(b) Initiation of insolvency proceedings

24. The Working Group discussed the need to achieve a balance between incentives for early initiation of proceedings and sanctions to compel early initiation. The view was expressed that the imposition of sanctions, such as those aimed at the liability of directors for trading whilst insolvent, had proven to be successful in a number of countries and had led to increased applications for reorganization. In other countries, however, while the sanctions were available, they were not consistently applied and were therefore ineffective as a means of compelling the initiation of proceedings. It was suggested that the imposition of such sanctions needed to be carefully considered to avoid situations where directors might take defensive decisions to avoid liability or, in the context of out-of-court processes, where directors might need to have immunity from liability in order to achieve a successful result. It was pointed out that the issue of liability was closely related to the extent to which management retained control and had an exclusive period to prepare a reorganization plan.

25. As a general recommendation, it was suggested that the draft Guide should consider each of the topic areas not only in terms of the key objectives set forth in Part One, but also in terms of the impact of each upon other topics and policies.

26. Different views were expressed with respect to initiation of proceedings and the party that should be able to apply. There was general agreement that debtors should have available to them both liquidation and reorganization procedures. As to initiation by creditors, although different views were expressed as to the relevant criteria, there was general agreement that creditors should be permitted to initiate both liquidation and reorganization proceedings.

27. In the case of initiation by creditors, support was expressed in favour of an application being made by one or more creditors, without specifying a particular number, while there was also support for the number to be specified. A concern was expressed that allowing an application by a single creditor might lead to the insolvency procedure being used as an alternative to ordinary debt enforcement procedures, since the debt might more appropriately be pursued elsewhere. Another view was that a criterion addressing the value of outstanding debts could be relevant so that a single creditor could apply in circumstances where the value of that creditor's debt was significant or a number of creditors could apply where the composite of their debt exceeded a certain specified amount. It was also suggested that the application criteria should specifically refer to unsecured creditors who had undisputed debts. On the question of the criteria for initiation of proceedings, one view was that the same criteria should apply to initiation by both the debtor and by creditors. Another view was that different tests should apply. In the case of a debtor, the application could be made on the basis of a general cessation of payments or the likelihood that the debtor would become unable to

pay its debts in the future as and when they fell due. It was suggested that that test might be reflected in the draft Guide along the lines of the debtor having "no reasonable prospect of being able to pay its debts."

28. In the case of creditor initiation, a view was expressed that, as noted in paragraph 51b. of document A/CN.9/WG.V/WP.54, creditors should be able to show that they held mature claims that had not been paid by the debtor. A preliminary issue raised was the need to clearly define the meaning of the term “maturity” to avoid disputes. A question was raised as to whether the debts really needed to be mature and due and whether the adoption of such a test might not limit access to insolvency proceedings unnecessarily and impact broadly upon the cost and availability of credit. That was stated to be particularly the case in situations where even though the debt was not mature, it was clear that the debtor’s situation would result in it not being able to pay when the debt became mature. It was pointed out, however, that providing no restriction on access could result in insolvency proceedings being used as an alternative to debt enforcement mechanisms. A related question was whether the mature debts needed to be held by applying creditors, or whether it might be possible for other creditors holding immature debts to apply on the basis that the debtor had mature, outstanding debts. It was suggested that where the criterion of maturity was included, there might need to be an exception to cover situations such as where the debtor was acting fraudulently, where there was evidence of preferential treatment of some creditors, or where proceedings were being commenced to implement a pre-negotiated reorganization.

29. On the question of whether the entry criteria for creditor applications should be the same for both liquidation and reorganization different views were expressed. One view was that to achieve the goal of timely, efficient and impartial access to insolvency proceedings, one of the key objectives noted in Part One of the draft Guide, the criteria should be the same and should be broadly formulated. To reflect that suggestion and the need to accommodate both unitary and dual processes, it was proposed that an approach along the following lines should be considered:

> “An application to open or commence insolvency proceedings may be made by:
>
> a. A debtor, in which case the debtor should show actual or prospective inability to pay debts or that the liabilities exceed the value of the assets of the debtor.
>
> b. One or more creditors that are owed a matured debt, in which case the creditor(s) should show that the debt has matured and is unpaid.”

30. It was noted that that proposal was intended to establish minimum agreed entry criteria, and that the draft Guide could note and discuss potential variations, such as a requirement for a minimum amount of debt or that the debt need not be mature. While there was agreement for taking that general approach, some support was expressed in favour of the test being that the debtor “is unable or will be unable to pay its debts as and when they fall due.”

31. A view was also expressed that entry criteria for creditor applications for reorganization should be more restrictive than for liquidation applications, with criteria such as a requirement for the creditors to be able to show that the business could continue to trade and could be successfully reorganized, being added. If those criteria were to be included, the view was expressed that clear guidance would need to be

provided as to what was required to be demonstrated, such as the availability of ongoing cash to pay debts for day to day running of the business, that the value of assets would support reorganization, and that the return to creditors would be greater than in liquidation. Concern was expressed that additional criteria could operate as a barrier to entry and it was suggested that they could only be considered in terms of the consequences of commencement and how the proceedings continued. It was noted, for example, that in systems where a stay applied automatically on commencement, the ability of the business to continue trading and be successfully reorganized could be assessed after commencement. In other systems, that information might be needed before commencement of reorganization, since the choice of that proceeding presupposed that it would lead to a greater return. It was also observed that the choice of entry criteria for reorganization depended upon the objective of the insolvency regime; if it was maximization of value the requirements would be different to those applicable where the objective was recycling of assets. The need to discuss those policy issues in the draft Guide was reaffirmed.

32. On the issue of the role that courts should play in commencement of proceedings, the view was expressed that while the court did not necessarily need to play a central supervisory role (that could perhaps be played by an administrative agency) parties should always have recourse to the courts to resolve disputes. It was pointed out that too much involvement of the court as the supervisory body might lead to delay and might render reorganization proceedings cost ineffective, particularly in the case of small and medium enterprises. It was also suggested that in some countries, such as those where the judiciary was very small, it was neither efficient nor effective to expect the courts to play a central role. Another view was that the role of the courts was central to supervision of the insolvency process and that that function could not be given to another body, however constituted.

33. The Working Group considered the proposal contained in paragraph 51c. of document A/CN.9/WG.V/WP.54/Add.1, concerning applications for insolvency proceedings made by governmental authorities. Wide support was expressed in favour of possible initiation of insolvency proceedings by such an authority. However, a shared concern was that vesting such an authority with a general power to initiate insolvency proceedings might create uncertainty and therefore be inappropriate.

34. The suggestion that the explanatory section of the draft Guide be expanded to mention specific violations of laws other than criminal laws (e.g. administrative or environmental laws) as factors possibly triggering initiation by the governmental authority was not supported. Furthermore, it was also noted that excessive expansion of situations enabling the public authority to file an application would exceed the scope of insolvency law.

35. Accordingly, the Working Group agreed that some criteria providing guidance as to the situations triggering that power and the manner in which it should be exercised, with a view to restricting the discretion of the relevant authority, should be provided.

36. Another suggestion was that the power of the governmental authority to initiate should apply not only to liquidation but also to reorganization proceeding, with a view to ensuring that the public interest be preserved in those situations when reorganization was possible but the debtor and the creditors failed to apply.

(c) Commencement

37. The Working Group considered a number of issues relevant to commencement of the insolvency proceedings. On the question of the need to ensure a speedy consideration of the application to commence proceedings, the general view was that that decision should be made promptly to avoid dilution of value and ensure certainty and transparency for creditors, particularly where commencement would affect their ability to exercise their rights. It was noted that entry criteria that were designed to facilitate early and easy access to the process would also facilitate the court's consideration of the application for commencement and that the question of timeliness thus was closely linked to what the court was being requested to do in making that commencement decision.

38. One view was that the decision for commencement should flow more or less directly from the simplicity of the entry criteria, avoiding the likelihood of delay and dispute. It was noted that in some systems, a voluntary application by a debtor was an acknowledgement of insolvency and would function as an automatic commencement, unless it could be suggested that the debtor was abusing the process to evade its creditors. With respect to reorganization, it was pointed out that the purpose of the entry criteria was to derive a standard that could create a presumption or prima facie case of insolvency. In such cases, unless the debtor's application was disputed, there should be no delay in commencing the proceedings, although commencement would not be automatic and some formal decision from the court was required. Another view was that the entry criteria was only the start of the process and the court would be required to carefully consider a number of related issues, such as whether the proceedings sought were the most appropriate for the debtor, before making a decision to commence the process. It was noted in response to that view that questions of assessment of the debtor and of the proceeding most appropriate to the debtor could be addressed through provision for conversion between liquidation and reorganization. There was support for the view that while a debtor application could operate to affect almost automatic commencement, that was not the case with an application by creditors which would be required to be determined in a timely manner.

39. The view was expressed that although a quick decision was desirable, the time period within which a decision could be made in practice differed from case to case and therefore it would be impractical to set time limits. Where laws did set time limits, it was pointed out that they were often ignored and it was difficult to establish effective sanctions to enforce such limits, particularly where it was a court (as opposed to an administrative authority) that was not observing the limit. It was observed that sanctions might be more appropriate to ensure that the debtor or creditor pursued its application in a timely manner. Another view was that a fixed time limit should be set to ensure certainty and transparency for both creditors and the debtor.

40. After discussion, the general view was that a flexible approach was required which would emphasize the desirability of speed and provide guidance as to what was reasonable, but also recognize that countries needed to fit their insolvency regime within the overall constraints and resources of their judicial systems and local needs for determining priority.

(d) Notice requirements

41. The Working Group considered the proposal contained in paragraph 54 of A/CN.9/WG.V/WP.54/Add.1 that notice of the application should be provided to the debtor (in the case of a creditor application) and to the creditors (in the case of a debtor application).

42. The Working Group agreed that notification of the insolvency proceedings was not only appropriate, but also crucial in order to ensure transparency of the insolvency system, in accordance with one of the major objectives pursued by the UNCITRAL Model Law on Cross-Border Insolvency and to ensure equality of information for creditors in the case of voluntary proceedings.

43. As to the time at which notification should occur, the prevailing view was that notification to the debtor and, respectively, to creditors should be treated differently. The concern was widely shared that immediate notification of an application filed by either creditors or a governmental authority (i.e., of an involuntary proceeding) to the debtor would be appropriate. Notification to the creditors prior to commencement on a debtor application, however, might be counterproductive as it could unnecessarily affect the position of the debtor in the event that the application was rejected and might encourage last minute actions by creditors to enforce their claims. The suggestion that such prejudice to the debtor would not be relevant in the case of a voluntary proceeding because the debtor had already made an assessment as to its insolvency did not receive support. It was noted that those issues would not arise in legal systems where commencement was an automatic effect of application.

44. After discussion, the Working Group agreed that notification of involuntary proceedings should not occur prior to commencement. It was noted that that solution was also consistent with the approach taken in Article 14 of the UNCITRAL Model Law on Cross-Border Insolvency, which clearly referred to commencement as the basis of notification. The Working Group also welcomed the suggestion that the draft Guide provide some guidance both as to the party required to give notice (e.g. the debtor or the court) and to the ways to ensure that the notification was effective.

3. Consequences of commencement of insolvency proceedings

(a) The insolvency estate

45. A general view was that the importance for national laws to provide clear rules as to the assets to be included in the insolvency estate needed to be stressed, to the benefit of both domestic and foreign creditors.

46. As to the specific assets which should be included, the general view was that all the assets in which the debtor had an interest as of the date of the commencement of the insolvency proceedings should be included, whether tangible and intangible and irrespective of whether those assets were in the actual possession of the debtor. The view was also shared that the insolvency estate should also include any assets acquired by the insolvency representative after the commencement of the insolvency proceedings. It was further suggested that specific contractual arrangements, like transfers created for the purpose of security, trusts or fiduciary arrangements and consigned goods, needed to be addressed. It was also observed that it would be useful if the draft Guide would expand the explanation of the notion of tangible and intangible assets.

47. Various views were expressed as to whether assets subject to a security interest in favour of a creditor should also be included. Some support was expressed for the view that as a general rule those assets should be excluded, unless one or more of them proved to be essential to the possibility of successful reorganization. It was pointed out that such a principle would significantly enhance the availability of credit, since it would reassure secured creditors that their interests would not be adversely affected by the opening of an insolvency proceeding.

48. However, support was expressed in favour of the view that secured assets should be included in the insolvency estate. It was observed that allowing secured creditors to enforce their rights on secured assets might not only impair the principle of equal treatment of creditors, but also the possibility of carrying out a successful reorganization. It was explained that retention of essentially all assets pertaining to the debtor at the outset of the procedure was crucial to achieve reorganization of the business. In that connection, it was also clarified that including secured assets in the insolvency estate would not be tantamount to saying that secured creditors would be deprived of adequate devices to preserve their rights. The view was also expressed that the emphasis should not be so much upon inclusion or not in the estate but whether the secured assets would be subject to the insolvency proceedings.

49. A proposal that secured assets should be subject to a different regime in liquidation as opposed to reorganization did not receive support.

50. A further view was that all assets pertaining to the debtor should be included in the insolvency estate irrespective of their geographical location, since that would be consistent with the approach taken in the UNCITRAL Model Law on Cross-Border Insolvency. In response, it was noted that the draft Guide was not intended to address questions of relevance to cross-border aspects of insolvency law, since those matters were addressed in the Model Law, which the current work was not intended to in any way modify or amend.

51. Wide support was expressed for the idea that, when the debtor was a natural person, some assets might be excluded from the insolvency estate. As to the identification of exempted assets, a suggestion was that exclusion should apply to claims for personal damages. After discussion, the Working Group agreed that, given the different approaches taken in various legal systems, it would be inappropriate for the draft Guide to include excessive details and that specific listing of exempted assets should be left to national laws. In that connection, the Working Group agreed that the draft Guide should recommend to national legislators to clearly identify those exemptions and to limit their number to the minimum necessary to preserve the personal rights of the debtor. It was further suggested that the text should identify and discuss the various policy options possibly underlying the different approaches taken in different countries.

52. The issue of the treatment of third-party-owned assets was also discussed. A concern was that, if those assets were to be excluded from the scope of the insolvency estate, the possibility to achieve reorganization would be significantly impaired. It was noted that in most cases at least some of the assets used for the operation of the business were in the ownership of a party other than the debtor and were retained by the latter on the basis of contractual agreements, including leases and the like. A suggestion was to include in the draft Guide the principle that third-party assets were not included in the insolvency estate, unless those assets were necessary to continue or maintain the operation of the business and provided that adequate provision was made for protection

of the lessor to the extent that those assets were utilized in the insolvency proceeding. That suggestion was supported.

53. Another view was that third-party assets should be treated differently depending on whether liquidation or reorganization was at stake. It was observed that, while in reorganization retention of assets in the possession of the debtor might prove crucial to the very possibility of rescuing the business, those needs did not arise in respect of liquidation. A different view was that preventing dismemberment of the estate at the outset of the procedure might prove crucial also for the purposes of ensuring the maximization of value within the context of liquidation.

54. A further view was that the issue of treatment of assets retained by the debtor pursuant to a contractual agreement should be addressed in the context of treatment of contracts rather than in the insolvency estate. In that connection, the view was widely shared that the rights of the owner under the contract should be restrained in order to ensure that the asset remained at disposal of the insolvency proceeding. In that connection, it was clarified that insolvency law would not affect title to the assets, but only limit the way in which those rights were exercised, with a view to preserving the needs of an insolvency proceeding.

55. The discussion showed that the notion of insolvency estate varied among the different legal systems: some laws appeared to consider the issue of third-party assets as pertaining to the rights of property, while some others appeared to address it within the context of treatment of contracts. However, the prevailing view was that the insolvency law should provide some mechanism to ensure that third-party assets used in the operation of the business remained available to the insolvency proceeding, both for the purposes of reorganization and with a view to maximizing the value of the assets subject to the proceedings.

56. General support was expressed for the right of the insolvency representative to recover property of the debtor that was improperly transferred in violation of the principle of equal treatment of creditors. Support was also expressed for the suggestion that the draft Guide clearly state the policy reasons that would justify such a right of recovery. A number of suggestions were made as to the kind of acts that would be subject to recovery and to the time periods in which recovery would be possible. A view was that, while the proposed text seemed to adopt an approach relying on the intention of the party, many legal systems relied rather on the detrimental effect of the transaction subject to avoidance and that in that respect a policy decision was needed. In response, it was noted that, given the variety of approaches taken by different legal systems in that field, the draft Guide should not include excessive details as to the conditions upon which that right of recovery could be exercised. It was also noted that detailed distinctions as to both the type of transactions and the relevant time periods were presented in the section of the draft Guide specifically devoted to avoidance actions. Accordingly, the Working Group agreed to defer further detailed discussion of that issue to a later stage.

(b) Stay of proceedings

57. In considering whether the application of the stay should be automatic or discretionary and whether it should apply on application for, or commencement of, insolvency proceedings the Working Group agreed on the need to distinguish between applications for liquidation and reorganization proceedings and the parties that may

make the application. It was observed that while the reasons for automatic application of the stay were clearly set forth in the draft Guide, the discussion of the advantages of a discretionary application needed to be expanded. It was recalled that the UNCITRAL Model Law on Cross-Border Insolvency addressed the issue of application of a stay and suggested that the approach adopted in the draft Guide should be consistent with the Model Law.

58. With respect to unsecured creditors, it was suggested that the stay should apply automatically to all creditors on an application for both liquidation and reorganization proceedings, irrespective of whether the debtor or creditors applied. Where the application was one for liquidation, continuation of the stay after commencement could be discretionary, but in cases of reorganization, the automatic stay would continue to apply after commencement. It was noted that a distinction might need to be drawn between those cases where the business was to be sold as an operating entity in liquidation proceedings and straightforward liquidation of the enterprise. A different suggestion which received some support was that the stay (which should apply automatically in both liquidation and reorganization proceedings, irrespective of whether those proceedings were initiated by the debtor or by creditors) should apply on commencement of the proceedings. To address the period between application and commencement, it was agreed that provisional measures should be available. Support was also expressed for the stay to apply automatically from the time of application where it was the debtor that applied, in order to avoid potential abuse by creditors. It was pointed out that such automatic application was of particular relevance in legal systems where an application made by the debtor led to automatic commencement without the need for any formal decision by the court.

59. As to the question of application of the stay to secured creditors, the general view was that if the secured interests were to be included within the scope of the stay it should be emphasized in the draft Guide that such inclusion should not be seen as a negation of the secured rights. The view was expressed that restricting the exercise of secured rights was necessary in both liquidation and reorganization proceedings to ensure that the goals of those proceedings could be realized, but that that had to be balanced by the maintenance and protection of secured rights. A contrary view was that secured creditors should not be included within the scope of the stay. It was suggested that to do so could undermine party autonomy and the bargain reached between the debtor and the secured creditor. In support of that view it was suggested that a system which applied the stay to secured creditors and sought to balance any negative impact by protecting the value of the secured interest was likely to be complex, costly and require the court to be able to make difficult commercial decisions on the question of appropriate protection. Where the stay did not apply to secured creditors, the matter was appropriately left to negotiation between the interested parties. On that point it was noted that there was a clear balance in many systems between the need for a stay and the availability and effectiveness of pre-commencement negotiations to achieve agreement between the debtor and creditors on how to proceed. It was pointed out that in a number of legal systems, pre-commencement negotiation was effective in achieving agreement between the debtor and its creditors so that a stay was not required. An alternative approach which received some support was to combine the automatic application of the stay on commencement for a short period to enable the financial situation of the debtor to be evaluated with a view to determining how the proceedings should continue, with provision for the stay to be lifted on application to the court where it could be shown that the value of the collateral was being adversely affected.

60. On the question of preferential or priority creditors, it was noted that there were different uses of those terms in different legal systems and that the draft Guide needed to explain those differences clearly. For example, in some systems priority creditors were creditors with possessory interests, while in others they had only a distribution priority. A related issue was the different rights that might be held by those different types of creditors and whether or not they were within the scope of rights to be affected by the stay. A general view was that a number of those types of creditors would be within the category of unsecured creditors affected by the stay, but it was suggested that the draft Guide should address the issues clearly.

(c) Treatment of contracts

61. The Working Group addressed the issues of termination, continuation and assignment by the insolvency representative of contracts that were outstanding at the time of commencement. As to termination, a general view was that there was a direct link between the ability of the insolvency representative to terminate contracts, on the one hand, and the level of availability of credit, on the other hand. It was observed that the wider the right of the insolvency representative to terminate, the higher the cost and the lower the availability of credit would be and that a careful balance needed to be struck between those two conflicting needs.

62. The issue of possible automatic termination of a contract in the absence of a decision to continue by the insolvency representative within a specified period was discussed by the Working Group. A view was that providing for such automatic termination might prove useful to avoid costs of litigation in respect of situations where it was clear that the debtor was not in the position to perform the contract. Furthermore, it was noted that failure to provide a mechanism for automatic termination would result in imposing on the insolvency representative the burden to notify the decisions in respect of all outstanding contracts, increasing the costs of the procedure.

63. However, the prevailing view was that the provision contained in the summary section (paragraph 113 (b) of document A/CN.9/WG.V/WP.54 Add. 1), stating that termination might be automatically effective in the absence of a decision to continue within a specified period of time, was too broad. Several views were expressed as to how the scope could be more focussed. One suggestion was that the text clarify that automatic termination would only be possible when expressly provided by the contract. In that connection, it was pointed out that allowing automatic termination as a general principle might expose the debtor to the risk of being deprived of some supplies which might be essential to the continuing operation of the business (such as electricity, water and the like). In response, it was noted that the rule was not aimed at giving the power to terminate the contract to the other contracting party, but rather at enabling the insolvency representative to avoid having to give notice of the decision to terminate. It was further clarified that the provision was not aimed at amending the rights that the other contracting party had under the contract. Another suggestion was to specify the period of time after which automatic termination would apply.

64. Another view was that automatic termination should be limited to some categories of contracts, as expressly identified by national laws. It was observed that, while supported by sound economic considerations, that mechanism might create an excessive amount of uncertainty, thus impairing the key objective of predictability of the insolvency system. A further concern was that automatic termination might give rise to

uncertainties when the insolvency representative was not adequately informed on the outstanding contracts.

65. It was pointed out that automatic termination was aimed at ensuring certainty: on the one hand, the mechanism forced the insolvency representative to make a timely decision in respect of the contracts outstanding at the time of commencement of the proceeding; on the other hand, it also offered the other party a way to eliminate uncertainties as to the continued existence of the contract within a reasonable period of time.

66. Another view was that the issue of automatic termination of contracts needed to be treated differently depending on whether liquidation or reorganization was at stake, given the different policies respectively underlying each proceeding. In that respect, it was observed that, while in liquidation it would be reasonable to assume that failure of the insolvency representative to take a decision in respect of a contract would most likely imply a decision to terminate, that assumption might not always be appropriate in reorganization.

67. The prevailing view was that the mechanism of automatic termination should be retained, subject to some limitations to its scope. Support was expressed for establishing in the draft Guide criteria that would guide the insolvency representative in making the decision as to whether to terminate the contract, bearing in mind that those criteria would be different for liquidation and reorganization. Furthermore, it was observed that outlining the policy reasons which might justify automatic termination would be most useful for those legal systems where the impairment of contractual rights required a specific justification.

68. In addition to the right to terminate contracts, it was suggested that the insolvency representative should have the power to disclaim other property included in the insolvency estate, whenever that property happened to be burdened in such a way that retention would require excessive expenditure. While some support was expressed for that view, it was observed that such a power would need to be accompanied by devices allowing disclaimed property to be vested in another person.

69. Support was also expressed in favour of the insolvency representative being able to ensure continuation of contracts. However, the Working Group agreed that that right should be limited in scope by excluding those contracts in respect of which continuation would be impossible: namely, contracts where the personal characteristics of the debtor were essential for performance of the contract. A suggestion was that examples (along the lines of those outlined in paragraph 106 of document A/CN.9/WG.V/WP.54 Add.1) should be included in the summary. Another view was that reference to the possible intervention of the court (as contained in the chapeau of paragraph 116 and in paragraph 116 (a) of document A/CN.9/WG.V/WP.54 Add.1) was inconsistent with the approach taken in respect of termination (where no reference to the court was made) and was therefore inappropriate.

70. Support was expressed in favour of mentioning the reasons underlying the right of the insolvency representative to continue the contract, as suggested in respect of termination. It was clarified that the right of the insolvency representative to continue the contract irrespective of the agreement of the other party should be balanced against the interests of the other party by some mechanism for compensation. It was also suggested that the other party should be given the right to be heard or consulted by the

insolvency representative prior to his or her decision as well as means to contest that decision.

71. As to the issue of assignment of contracts, one view was that the scope of the provision should be limited, as in the case of continuation. In that connection, it was pointed out that the possibility of assignment should be excluded in respect of those contracts in which the specific characteristics of the debtor were essential to performance. In that respect, it was suggested that the insolvency representative could not be vested with rights wider than those pertaining to the debtor under the contract.

72. After discussion, the prevailing view was that the right of the insolvency representative to assign the contracts outstanding at the time of commencement should be retained, subject to adequate limitations to its scope. In support of that view, it was also observed that under some circumstances termination may result in a windfall for the other contracting party (e.g. where the contract lease price was lower than the market price) and that providing for a contract to be continued and assigned may enable the insolvency estate to benefit from the difference between the contract and the market price.

73. As to the issue of non-assignment clauses, support was expressed in favour of enabling the insolvency representative to treat such clauses as null and void, but that the draft Guide should point out the consequences of such treatment vis-à-vis the other party. It was further noted that that solution was consistent with the approach taken in the draft Convention on the Assignment of Receivables in International Trade. Another suggestion was that the bracketed reference to “all parties” appearing in paragraph 118 (b) of document A/CN.9/WG.V/WP.54 Add.1 be clarified to make it clear that the reference was to the parties of the original contract and not to the parties of the assignment.

74. A general view was that the draft Guide should point out the need for excluding financial contracts (including currency swaps, interest rate swaps, derivatives and the like) from the scope of the provisions enabling the insolvency representative to interfere with contracts. It was observed that preserving the rights of financial investors (in particular, the right to net their positions, the right to terminate the contract and the right to claim for collateral in accordance with the rules and arrangements governing those contracts) was crucial in order to ensure the stability of the financial market as a whole. It was further noted that such special treatment appeared appropriate in the light of the peculiarities of those contracts and that such peculiarities had similarly led to their exclusion from the scope of application of the draft Convention on the Assignment of Receivables in International Trade. While that view was supported, it was also agreed that the reasons supporting a special regime for those contracts, entailing a significant exception to the principle of equal treatment of creditors, should be pointed out in the draft Guide.

75. Wide support was expressed in favour of the view that employment contracts should be subject to a special regime, given the strong social implications of their treatment within the context of insolvency. A suggestion was that the draft Guide should mention the social policy considerations underlying the issue and the reasons justifying their exclusion from the scope of the general rules. A further suggestion was that the draft Guide recommend that the limited power of the insolvency representative to terminate those contracts should also be expressly mentioned in the insolvency law, for the purpose of transparency.

76. The prevailing view was that the issue of set-off should be dealt with in the draft Guide. The suggestion that that issue should not be addressed in the context of treatment of contracts, being rather an issue of general private law, was not supported.

(d) Avoidance actions

77. At the outset of the discussion in the Working Group it was observed that avoidance actions were potentially very expensive to run and it was suggested that the Working Group should direct its attention towards devising criteria that would assist in simplifying those actions. It was noted that in some legal systems an individualized approach which considered in some detail questions such as the intent of the parties to the transaction and what might constitute the normal course of their business arrangements had led to excessive litigation. That subjective approach had now been changed to a more simple objective approach which combined a short time limit for the suspect period (3-4 months) with an arbitrary rule that all transactions occurring within that period would be suspect unless there was a roughly contemporaneous exchange of value between the parties to the transaction.

78. It was noted that the potential expense of avoidance actions had led some legal systems to consider how those costs might be funded. Possible approaches included allowing individual creditors to pursue the action where the insolvency representative chose not to pursue it, provided other creditors agreed; permitting the insolvency representative to assign the action for value to a third party; and allowing the insolvency representative to approach a lender to advance funds with which to commence the avoidance action. It was noted that some of those approaches would result in the creditor taking the action being able to cover its claim out of the funds recovered or at least some part of it. In other systems, it was noted that the government would provide funds for the insolvency representative to take not only avoidance actions to recover funds, but also actions against directors. Some concern was expressed with regard to approaches that might serve the interests of individual creditors and depart from the collective nature of the insolvency proceeding. In support of mechanisms that allowed private funding, it was pointed out that there were vast differences between countries in the availability of public resources for funding avoidance actions. An additional difficulty could arise where such actions were required to be funded from the assets of the estate, particularly as that might operate to prevent the recovery of assets which had been removed from the estate with the specific intention of hindering avoidance actions. After discussion, support was expressed in favour of a mechanism that would allow creditors to pursue recovery where the insolvency representative was unwilling to do so or to obtain external funding where no other option was available.

79. The Working Group discussed the types of transactions that might be subject to avoidance actions as set forth in paragraphs 125-129 of document A/CN.9/WG.V/WP.54/Add.1. As a preliminary point it was noted that the power to take avoidance actions should be available in both liquidation and reorganization. It was pointed out that reorganization, like liquidation, involved allocation on the basis of priorities. Accordingly where a creditor had obtained a benefit shortly before commencement that would affect its priority it should not be able to retain that benefit.

80. On the issue of the scope of avoidance powers, it was suggested that the draft Guide should refer to transactions rather than to payments or to transfers, as the latter two terms were too narrow. It was also suggested that the principal categories of avoidable transactions should be fraudulent, undervalued and preferential transactions, with other

categories such as invalid security interests, gifts, setoffs, unauthorized transfers occurring after initiation of insolvency proceedings and transactions seriously inconsistent with normal commercial transactions included as specific examples of those three categories. In discussing those various categories, the draft Guide should indicate the categories of transactions that would be void and not merely suggest which transactions might be avoidable. A further suggestion was that the draft Guide should focus not simply upon the types of transactions as described above, but also upon the consequences of the transaction and the relationship between the parties involved in the transaction. In terms of the consequences, the example was given that directors might seek to pay off all the liabilities which they had guaranteed in the period before insolvency. While the payments in themselves might be acceptable, the effect of such payments needed to be considered. As to the relationship between the parties, it was noted that transactions with insiders might require special attention. It was recalled that the Working Group had agreed to the exclusion of financial transactions from the power of the insolvency representative to interfere with contracts and that therefore they should not be subject to avoidance.

81. As a general point with regard to the suspect period, one view was that the periods should be set forth in the law and not left to retrospective determination by the courts, since that approach did not assist clarity and predictability of the law. Another view was that a degree of flexibility could be added to the law by allowing the court to extend the fixed periods in certain circumstances. In was noted that some countries adopted this combination of objective and subjective criteria. In response, it was pointed out that such an approach might not serve the goals of predictability and certainty that were key objectives as noted in Part One of the draft Guide. It was nevertheless suggested that there might be circumstances in which extension of the suspect period might be appropriate, for example, where a transaction that had been concealed had the effect of diminishing the estate. It was also pointed out that the draft Guide needed to be clear on when suspect periods commenced i.e. whether on application or commencement (where that meant the making of the insolvency decision) of the insolvency proceedings.

82. In respect of fraudulent transfers, the Working Group agreed that they should be subject to avoidance. In terms of a suspect period, one view was that avoidance of transactions on the basis of fraud should not be restricted to a particular time. Another view was that a time period was required but that it should be long.

83. On the issue of burden of proof, it was suggested that the question to be considered was whether the transaction was intended to, or had the effect of, hindering, delaying or depriving creditors of value. It was observed that since intent was the essential element of fraud, it would not be sufficient for the transaction to have the effect of defeating or delaying creditors unless that effect was intended. In addition, it was suggested that the fraudulent intent must be recognizable to the other party to the transaction. As a practical matter, it was observed that if a party could not explain the commercial purpose of a particular transaction which extracted value from the estate it would be relatively easy to show that the transaction was fraudulent. The Working Group's attention was drawn to the need to bear in mind that many transactions that were perfectly valid under non-insolvency law were potentially fraudulent under insolvency law.

84. With respect to the question of whether the transaction should be automatically avoided by operation of the law or voidable on the application of the insolvency representative, it was noted that a distinction had to be made between fraudulent transactions, which could not be automatically avoided and the other types of

transactions which could be automatically avoided by reference to a fixed suspect period.

85. In discussing transactions at an undervalue, it was pointed out that there was a need to distinguish between those transactions involving creditors and those involving third parties, as the latter could also be classified as gifts. It was suggested that a long suspect period was required for transactions at an undervalue.

86. In relation to preferential transactions, it was noted that the criterion was whether the transaction involved a contemporaneous exchange of value. Examples could include irregular payments made in respect of debts not yet mature. It was suggested that such transactions were broader than just payments to creditors and should include not only transactions for the benefit of creditors, but also transactions with third parties. In response, it was pointed out that the preferential nature of the transaction would be hard to define in the context of third parties and that transactions involving a preference to third parties could be classified as transactions at an undervalue or as gifts (although it was noted that some legal systems might permit certain gifts to be made). It was suggested that transactions involving payment in kind could also be included. As to the suspect period required, it was suggested that it should be shorter than that applicable in the case of fraudulent or undervalued transactions.

87. Some concern was expressed as to what invalid security interests as a category of avoidable transaction referred to. It was generally agreed that that category would cover security provided on the basis of past consideration. It was suggested, however, that it might also include securities such as liens that were not properly perfected and could be avoided under non-insolvency law. The Working Group added that, as a general matter, the issues relating to the validity or invalidity of secured interests should properly be the province of the relevant secured transactions law and should be the subject of cooperation between the Working Group on Insolvency Law and the Working Group that will commence its work on secured transactions in May 2002.

88. The view was expressed that setoff was not avoidable as such, but that it might be where the effect of the setoff was to alter the balance of the debt between the parties to the setoff in such a way as to create a preference, or where the setoff occurred in irregular circumstances such as where there was no contract.

89. Where unauthorized transactions occurred after the application for the proceedings and before commencement, the transaction should be void, not voidable to avoid disputes. In respect of a further category, that of transactions inconsistent with normal commercial practice, the view was expressed that it was more in the nature of a defence to an allegation of a preferential transaction where it could be shown that the transaction was consistent with normal practice or consistent with the normal course of dealings with the particular creditor. A contrary view was that those types of transactions should be included as a separate category. It was suggested, however, that the criteria of “inconsistent with normal commercial practice” would be difficult to determine, particularly where the transaction appeared on the surface to be in the ordinary course of business, but only on close examination was revealed not to be. It was also noted that such criteria raised an issue of who should be charged with making that determination.

4. Administration of proceedings

(a) Debtor's rights and obligations

90. It was generally felt that the issue of the rights and obligations of the debtor were different in liquidation and reorganization. Where the business was to be continued (either for sale as a trading entity or reorganization) a greater need for debtor involvement arose.

91. General support was expressed for the obligation of the debtor to disclose in a timely manner full information as to the financial and economic situation of the business, with a view to preserving confidence and allowing proper evaluation of the business by the insolvency representative. In respect of reorganization, it was noted that prompt submission of information by the debtor might be useful to enhance the confidence of the creditors in the ability of the debtor to continue managing the business. A suggestion was that that duty should extend to all relevant information and include information also in respect of the years prior to the initiation of the proceeding.

92. In respect of reorganization, the Working Group agreed that continuing involvement of the debtor in the management of the business was desirable and appropriate. The possible advantages of that approach, especially in respect of individual businesses or small partnerships, were pointed out. Where the debtor retained a significant role in management, such as in the debtor-in-possession approach, supervision by the court was necessary (and might include the appointment of an insolvency representative). It was generally felt that the powers given to the debtor within the context of reorganization should be balanced by providing efficient mechanisms enabling creditors to take appropriate action. In that connection, it was observed that the primary responsibility of the debtor after the commencement of the proceeding would be vis-à-vis the creditors rather than to the shareholders. It was further observed that the power of the court to appoint an officer to act as mediator would be useful to address situations where the apathy of creditors might hinder the preparation and approval of the reorganization plan. Another suggestion was that differences in treatment of rights and obligations of the debtor might be introduced depending on the size of the enterprise.

93. Support was expressed in favour of an approach that relied on sharing of rights and responsibilities between the debtor, on the one hand, and the insolvency representative appointed by the court, on the other hand. Under that approach, the debtor would continue to run the business on a day-by-day basis while the insolvency representative would supervise relevant transactions and be responsible for the implementation of the plan.

94. After discussion, the Working Group agreed that it would be advisable to draw a distinction between the period between initiation of the insolvency proceedings and the approval of the reorganization plan, on the one hand, and the period following that approval, on the other hand. It was felt that, while in the first time span it would be appropriate for legislation to set out specific rules and provide for an independent representative to be involved, a more flexible approach, giving a wider scope to party autonomy, might be advisable during the period following the approval of the plan and throughout its implementation, with a view to enhancing the chances for successful reorganization.

95. The Working Group discussed the issue of the right of the debtor to be heard. A concern was that, if stated as a general principle, that right might lead to formalities and costs unnecessarily impeding the course of the proceeding, especially in the context of a liquidation proceeding. It was therefore suggested that that right be limited to situations where the debtor had an interest, in respect of both its financial situation and its personal rights. In response, it was noted that some systems considered the right to be heard as a fundamental right of a constitutional nature and that restrictions thereto might result in making it more difficult to grant recognition of procedures carried out in systems allowing those restrictions. It was further noted that providing for the debtor to be involved in decisions as a general rule might ultimately enhance the confidence in the insolvency system. Accordingly, it was agreed that the draft Guide should emphasize the need to avoid the exercise of that right resulting in abuse which would adversely affect the expeditious carrying out of the procedure.

96. A further suggestion was that issues such as the release from restrictions imposed on an individual debtor as a consequence of commencement, as well as discharge from all or some debts following termination of the procedure, should be addressed in the draft Guide.

(b) Insolvency representative's rights and obligations

97. As to who should appoint the insolvency representative, it was suggested that any solution should foster the selection of an independent and impartial person; the appointment by the court or creditors was generally considered as more conducive to independence and impartiality than the leaving the appointment to the debtor. In that regard it was noted that debtor appointments had the potential to lead to substantial disputes concerning creditor claims and discrimination towards creditors. It was further noted that there was a trend towards appointment of the insolvency representative by an independent appointing authority that could draw upon professionals with experience and knowledge of relevant sectors.

98. Statements were made regarding procedures that governed the selection of insolvency representatives in various countries; those statements were made by way of information or as suggestions to be taken into account in formulating recommendations for the draft Guide. Those included that the prospective insolvency representative should be required to disclose circumstance that might indicate a conflict of interest or lack of independence; that candidates for the office had to undergo training by specified institutions and be licensed; that representatives were chosen from a roster under systems that were designed to be fair to representatives (in terms of distributing cases in which assets did not allow for a full remuneration of the representative) but did not necessarily guarantee the choice of the most appropriate person in each case. It was observed that in establishing such procedures and requirements, one should be mindful that overly stringent requirements had the disadvantage of raising the costs of proceedings, while requirements that were too low would not guarantee the quality of the service required.

99. On the question of the qualifications required of an insolvency representative, the view was expressed that paragraph 145 of document A/CN.9/WG.V/WP.54/Add.1 adequately reflected the issues to be considered. It was suggested that a reference could be added to the need for the insolvency representative to be a "fit and proper" person and the fact that it performed different fiduciary roles. It was also suggested that the draft Guide might make mention of the need for a public officer to be appointed in cases

where an insolvency case could not assigned for a private insolvency representative where, for example, there were no assets to fund the administration of the insolvency.

100. It was recognized that the insolvency representative was to be subject to standards of responsibility, but that those standards should be in line with the circumstances in which the representative took decisions; in that light, suggestions were made that the standard of responsibility was not to be more stringent than that of a manager of a company, that it should be along the lines a standard expected of a prudent person in his or her position or that the standard be based on the expectation that he or she act in good faith on proper purposes; it was stated that the standard of care should not be too stringent (in particular should not be the standard of care applied in tort cases) so as not to invite law suits against the representative and thereby raise the costs of the service.

101. It was suggested that the provisions on replacement or removal of the representative should be linked to the representative's failure to act according to the required standard, with the reservation that, depending on the role and prerogatives of creditors given in the proceedings, it might be appropriate to leave the creditors free to remove the representative without having to give any justification therefor. In that respect it was suggested that where the draft Guide dealt with removal, whether or not for cause, it should also discuss the need for the insolvency law to provide for substitution and succession in title to the assets of the estate. It was noted that insolvency representatives were regarded in some countries as officers of the court, which determined their level of responsibility and grounds for removal.

102. As to the need for liability insurance of insolvency practitioners or an obligation to provide a guarantee to cover any breach of their duties (such as a bond by a surety company), it was suggested that those obligations should be in line with the proper distribution of risks among the participants in insolvency proceedings and should be balanced against the need to control the costs of the service.

(c) Creditor claims

103. The Working Group discussed the issue of submission of claims by creditors. One view was that a specified period of time within which that submission should occur was advisable for the purpose of certainty. A related view was that sanctions for late filing should be provided. However, the concern was raised that providing a specified time limit for submission of claims might result in discrimination against foreign creditors, who in many cases might not be able to meet the time limit. It was observed that that result would entail a violation of the principle of equal treatment of domestic and foreign creditors, as set forth in article 13 of the UNCITRAL Model Law on Cross-Border Insolvency. It was further pointed out that that result would be inconsistent with the international trend in insolvency law reform, which was clearly towards the abolition of any discrimination based upon nationality of the creditor. It was also clarified that the absence of a specified term would be of no detriment to the insolvency estate, provided that the claim was lodged prior to distribution of the assets and provided that any cost arising in connection with the late filing be borne by the creditor. Another view was that, if a time limit were to be introduced, it should not have a preclusive effect.

104. In response, it was observed that that concern could be adequately addressed either by introducing longer timer limits, or by providing a specific time limit for foreign creditors, as was already the case in some legal systems, or allowing the court to extend the time period upon evidence of serious impediment. It was also suggested that that

option should also be open to domestic creditors. It was further noted that the question of late filing of claims by foreign creditors was closely related to provision of adequate notice to those creditors and that the draft Guide should refer to the obligation to adequately inform foreign creditors set forth in the UNCITRAL Model Law on Cross-Border Insolvency. It was also observed that the establishment of an international database containing information drawn from national commercial registries would be useful to provide timely information to creditors and assist in ensuring equal treatment of creditors.

105. With regard to foreign creditors, the issue was raised as to whether claims could be submitted in a language other than the one of the insolvency proceedings. The Working Group agreed that allowing a creditor to submit the claims in its own language might significantly facilitate access of foreign creditors. Accordingly, it was suggested that the draft Guide recommend that national laws reduce the constraints deriving from documents having to be submitted in a specific language or be subject to specific formalities such as translation and notarization required by national law.

106. It was pointed out that equal treatment of foreign creditors was linked to the issue of conversion of claims expressed in a currency other than the one of the country of the insolvency proceeding, namely in respect of the time at which that conversion were to take place. It was noted that, due to the continuous fluctuations of currency rates, establishing the conversion at the commencement of the proceeding, rather than at the time of filing or of distribution, might result in significant variations in the amount of the claim. The view that conversion should occur at the same time when interests on claims ceased to accrue, i.e. at the time of commencement, was not supported. The Working Group agreed that the draft Guide should draw the attention to that issue, outlining the various options available without however suggesting a specific approach.

107. The idea that the statement of claims should be prepared by the insolvency representative rather than by the court received wide support, since it was felt to be consistent with the desirable objective of reducing the formalities encumbering the process of verification of claims. It was pointed out that those formalities could be further reduced if admission of claims on the basis of appropriate declarations (such as affidavits) entailing penal sanctions in the event of fraud, as well as inclusion of claims evidenced by properly kept accounting books, were allowed. Notwithstanding general support for the goal of ensuring effectiveness and simplicity, it was however pointed out that the draft Guide should clarify that the decisions of the insolvency representative to either admit or reject a claim would be subject to appeal to the court.

108. A concern was that that solution relied heavily on the discretionary powers of the insolvency representative and might therefore easily lend itself to delays or even collusion with the debtor, thus undermining the predictability of the system. Therefore, it was suggested that claims outstanding at the time of commencement should be admitted on an automatic basis, without prejudice to the possibility to resort to court in order to contest admission or exclusion of a specific claim. It was observed that such a system would need to be accompanied by a mechanism aimed at ensuring that adequate information as to the claims included on an automatic basis be available to all interested parties.

109. The advantages of a system providing for automatic admission of claims were recognized by the Working Group. It was observed that admission of claims on an automatic basis would avoid most of the difficulties linked with the insolvency

representative having to make a precise assessment of the situation at the outset of the proceeding to enable creditors to participate in and vote at meetings held at an early stage of the proceedings. After discussion, it was agreed that both options should be retained in the draft Guide and presented as possible alternatives for adoption.

110. Various views were expressed in respect of the types of claims that should be excluded. It was observed that, while many countries currently took the approach of excluding foreign tax claims, there was no reason why national legislators would not be free to admit them, if they so wished. While it was suggested that foreign tax claims should be given the same treatment as domestic tax claims, the prevailing view was that the draft Guide should set forth the various alternatives available to national laws without recommending a specific approach. It was also stressed that the draft Guide should remain consistent with the approach reflected in article 13, footnote 2 of the UNCITRAL Model Law on Cross-Border Insolvency, providing that the equal treatment of foreign creditors did not affect the exclusion of foreign tax and social security claims from the insolvency proceeding.

111. With respect to the exclusion of fines and penalties, support was expressed in favour of providing a different treatment for, respectively, fines and penalties of a strict administrative or punitive nature (such as fines imposed as a result of an administrative or a criminal violation) and fines and penalties having a compensatory nature. While exclusions of claims of the first nature was generally deemed justified, it was felt that there would be no reason to exclude claims belonging to the second category. A further view was that there was no sound policy reason supporting exclusion of fines and penalties, since unless they were provable, they could not be collected unless they were not subject to the stay. In response, it was observed that that exclusion might be justified with a view to increasing the assets available for unsecured creditors.

112. As to gambling debts, it was pointed out that the reason why in most systems those debts were excluded from admission was that they arose from activities not permitted by the law. Accordingly, it was agreed that the draft Guide should rather focus on the general principle that claims arising in connection with activities which national law considered unlawful, and thus unenforceable, could not be admitted. Furthermore, it was observed that exclusions based upon public policy reasons should also remain unaffected by the insolvency law.

113. Given the different policy options which might support each of those exclusions, it was suggested that the draft Guide should bring examples as to the types of claims that national law might wish to exclude and the different approaches that might be taken from the standpoint of the insolvency law.

114. A suggestion was that claims held by persons connected to the debtor should be subject to a special regime, where they would be subordinated to all other claims and excluded from voting. In response, it was observed that the draft Guide should not suggest a specific treatment for those claims but only remind national legislators of the need to address them.

115. As to the submission of claims by secured creditors, one view was that those claims should be admitted on a provisional basis, due to the difficulties to make a precise assessment of the value of the collateral at the outset of the proceeding. In that respect, it was noted that providing for submission of secured claims, even on a provisional basis,

would be useful for the purpose of informing the insolvency representative of their existence.

116. General support was expressed for the suggestion that the draft Guide clearly point out the existence of different classes of creditors, each of which was characterized by its own rights and prerogatives. While it was felt inappropriate for the draft Guide to suggest which classes should be given priority or what treatment should be reserved to each of them, the prevailing view was that clear identification of the admitted classes, as well as of the prerogatives respectively pertaining to each of them, should be recommended to national legislators. It was also felt that any difference in treatment depending on whether liquidation or reorganization was at stake should also be clearly pointed out by national laws. The view was shared that, as a matter of general policy, the draft Guide should recommend that equality of treatment among creditors should be pursued and that any exceptions had to be supported by clearly identified policy reasons. Support was also expressed for the suggestion to include in the draft Guide reference to the financial and economic impact of the various approaches that could be taken at the legislative level.

117. With respect to the treatment of loans granted by shareholders, a view was that those loans deserved a regime which took into account the specific reasons usually underlying their issuance, which would not necessarily be the same as in the case of loans by other entities. As a general remark, it was pointed out that the draft Guide should make national legislators mindful of the possible implications of legislative choices at a corporate governance level.

118. The suggestion that the draft Guide should address the issue of the treatment of joint obligations under insolvency law received significant support. In particular, it was suggested that it should address whether and to what extent the commencement of the insolvency proceeding would affect the right of a creditor to enforce the claim against one or more joint debtors other than the one subject to the proceeding. In that respect, a further view was that treatment of guarantors should be included in the draft Guide and that the situation where the guarantor was also insolvent should be addressed.

119. A further view was that the draft Guide should recommend to specifically address the issue of treatment of unsecured claims acquired after commencement of the insolvency proceedings by outlining the different approaches available under various legal systems. Another suggestion was that the issue of set-off was critical to ensure equal treatment of creditors and should therefore be dealt with by the law as a specific issue of creditors claims.

120. Finally, the Working Group discussed whether the insolvency law should provide for a mechanism of what is in some legal systems known as “equitable subordination”. It was pointed out that, in those systems which allowed it, that mechanism was aimed at ensuring equality of treatment of creditors by undoing or off-setting inequity in a specific claim that would produce injustice or unfairness to other creditors within the context of an insolvency proceeding. It was further clarified that that mechanism was deemed to be exceptional in nature and therefore available under specific circumstances and upon demand of the interested party to the court only. It was pointed out that the remedy would require that the inequitable conduct of the claimant had resulted in harming other creditors or conferring an unfair advantage on the claimant and that the granting of the remedy would not be inconsistent with insolvency law. Some situations usually allowing the remedy to be granted were mentioned, including: a fiduciary of the

debtor misusing its position to the disadvantage of other creditors; a third party controlling the debtor to the disadvantage of other creditors (for instance, by way of threatening to withdraw financing so as to force the business to be closed); or a third party defrauding other creditors (for instance, by way of submitting misleading information). Finally, it was noted that equitable subordination would be granted only up to the amount of the harm resulting from inequitable conduct and that it would not be available in respect of the exercise of normal rights conferred upon the creditor by either statute or contract, unless misconduct was shown.

(d) Creditor committees

121. Different views were expressed as to the role that a creditors committee could perform. One view was that creditors committees could perform a useful consultative role, assisting the insolvency representative by discussing difficult issues and providing advice but not participating directly in decision making. It might also have a role to play in checking upon the insolvency representative or the debtor's management where it retained a significant role in the day-to-day management of the business. Another view was that the creditors committee could play a more active role in decision making. In relation to how the committee might operate, it was suggested that there was a need for the powers of the creditors committee to be clearly stated, and to avoid disputes and, in particular, to ensure confidentiality, for the committee to operate on the basis of agreed rules.

122. It was suggested that whether or not a committee was needed might depend upon the nature and size of the case and whether it was a liquidation or reorganization. In liquidation, it was observed that a committee was not always needed, but that there might be exemptions such as in the case of the sale of the business, where the creditors committee could be a source of expert advice. On that basis, it was suggested that the committee should have a consultative role in liquidation. In reorganization, it was noted that the input of a creditors committee was generally useful and necessary, but that a flexible approach should be adopted as to what functions the committee should perform. It was suggested that, as a general proposition the committee should perform an advisory function with some clearly defined exceptions. Those would include the committee playing a central role in development of the reorganization plan, in the sale of significant assets, and where requested by the insolvency representative or directed by the court. With respect to those four instances, it was suggested that the committee should have the ability to appoint financial, legal and other advisers as required, but not where its function was only advisory.

123. In terms of the creditors to be represented on the committee, one view was that it should be limited to the largest unsecured creditors and not include priority or secured creditors. Another view was that representation should be determined on the basis of the size and type of debt, where the type of debt was to be determined by reference to criteria other than the secured or unsecured nature of the claim. A further view was that the insolvency regime did not have to specify which creditors should be represented, but should adopt a flexible approach which would allow creditors to choose their own representatives on the basis of willingness to serve and provide for enlargement or reduction of the size of the committee as required. Where the different types of creditors requiring representation was too diverse, it was suggested that different committees could be established to represent different interests, but that that approach should be taken only in the case of special interests such as tort claimants and shareholders. It was

also suggested that the insolvency law could stipulate which parties could not participate in the committee, such as the debtor or a party related to the debtor.

124. With respect to the liability of creditors committees, it was observed that the fact that members of the committee were not remunerated for participating in the committee would suggest a low level of responsibility. While it was noted that establishing liability for creditor committees was likely to promote creditor apathy, support was expressed for an approach based upon good faith which provided immunity for members in respect of actions taken by them in their capacity as members of the committee unless they were found to have acted improperly or to have breached a fiduciary duty to the creditors.

(e) Post-commencement finance

125. It was generally noted that it was essential for a business in reorganization to have access to cash flow if it was to be able to continue to trade and successfully reorganize. It was observed that in situations where it was permitted by the law, the debtor could use its cash collateral to secure finance, but where this was not available, post-commencement funding would have to be obtained in some other way. Examples were given of a "superpriority" (a priority that ranked in advance of administration expenses) and a "priming lien" (which ranked ahead of existing security interests but were rarely granted without the consent of the secured creditor). It was noted that post-commencement finance was likely to come from two types of lenders. The first was pre-insolvency lenders who had an ongoing relationship with the business and were likely to advance further funds in order to protect their existing claims and perhaps gain additional value through the higher rates charged for new lending. It was noted that that source of post-commencement finance was the most common. The second type of lender had no pre-insolvency connection with the business and was likely to be motivated only by the possibility of high returns. It was observed that the inducement for both types of lender was the predictability of the recognition accorded to post-petition lending and, in respect of existing lenders, confidence that their relationship to the debtor and the terms of their pre-commencement lending would not be changed.

126. Some concern was expressed with respect to the two forms of priority mentioned. It was suggested that the possibility of establishing priming liens might negatively affect the availability of credit to businesses in general. Only secured creditors who would be affected by the priming could agree to be displaced by such forms of security. The decision to obtain such finance therefore was not one that could be taken solely by the court, the insolvency representative or the general creditors. A further concern was how such a priority would be treated in the event that the reorganization failed and the proceedings were converted to liquidation, particularly as it might relate to the established priority for administration expenses. It was noted that a distinction needed to be drawn, in terms of the provision of finance, between the different stages of the reorganization process, such as the post-application, pre-plan and post-plan periods, with only the latter period being addressed by the plan. A question was raised as to whether the issue of post-commencement finance might not also be relevant in the case of the sale of the business in liquidation.

(f) Reorganization

127. At the outset of the discussion it was suggested that the draft Guide should include a discussion of why reorganization was desirable and the need in some countries to remove legal obstacles to the development of flexible procedures for reorganization that

could take account of the advantages and disadvantages of different procedures in combinations that would enable the goal of maximizing value to be achieved.

128. The Working Group discussed the development of secondary debt markets. Those markets had increased trading in debt that, in turn, had had an impact on the way in which relevant participants approached reorganization procedures. It was noted that banking practice had changed significantly in some countries over the last 20 years so that banks were increasingly selling their claims to better manage their risks and create liquidity, rather than waiting for long periods to receive a dividend from insolvency proceedings. It was observed that that trend had the potential to significantly complicate insolvency proceedings, because the parties negotiating a reorganization arrangement could change throughout the currency of the negotiations and because the objectives and interests of those secondary debt purchasers might differ from those of the original creditors, particularly in terms of their interest in returning a profit from their acquired debt rather than in the rescue of the business and the importance of ongoing business and commercial relationships.

129. Although it was apparent that insolvency law did not necessarily need to be changed to address that trend (and no examples of such changes were given), it was noted that there were implications for the insolvency process in terms of membership of creditor committees and the relationship of the parties that might purchase the debt to the debtor. With respect to creditor committees, it was noted that allowing debt traders to participate raised a potential problem of access to sensitive information that could assist their business. There was also a potential for debt traders to misstate the likely value of dividends to encourage creditors to sell at a discount at an early stage of the proceedings. A further issue was whether parties related to the debtor could purchase claims and if so, what mechanisms might need to be adopted to address possible problems. It was suggested, as an example, that a claim against the estate by such a purchaser could be limited to the amount actually paid for the debt, rather than the face value of the debt, where an unrelated third party could claim the face value of the debt. A further mechanism would be to exclude the votes on a reorganization plan of those related parties.

130. The Working Group considered the ways in which insolvency systems dealing with reorganization differed in terms of essential framework. Two principal models were identified, although it was pointed out that some issues were treated similarly in the different models. It was noted that one model relied upon the notion of providing adequate protection for secured creditors. Under that model governance issues would require greater involvement of the courts; there was a requirement for a stay to be applied, with different approaches being adopted as to the period of application of the stay and the period over which the business could be assessed; and there was provision for dissenting creditors to be bound to the plan where the secured claim was appropriately provided for and it was in the interests of all participants in the proceedings to do so (a “cram-down” provision).

131. The other model, used in systems with a strong secured creditor tradition, generally had no, or a limited, application of the stay of proceedings, with the period of the stay being used to evaluate whether a greater return could be expected from reorganization than from liquidation. Governance issues were normally dealt with by an insolvency representative; there was less court involvement than in the first model, as the question of adequate protection for secured creditors did not arise; and there was a reluctance to provide for a cram-down of secured creditors. An underlying assumption of the secured

creditor model was that the creditors would generally agree where it was demonstrated that the return in reorganization would be greater than in liquidation.

132. The question was raised of how the sale of a business as an operating entity should be treated and, in particular, whether it should be treated in the context of liquidation or reorganization (one of a number of questions posed to the Working Group on page 44 of document A/CN.9/WG.V/WP.54/Add.1). It was suggested that the sale of a business as an operating entity was not incompatible with liquidation and also would be a viable option in reorganization. It was agreed that for the purposes of discussion there should not be a strict delimitation drawn between the two procedures and that whatever was an appropriate procedure for the purpose of maximizing value should be available.

(i) Preparation of a plan

133. A number of options for preparation of the reorganization plan were considered. One suggestion was that preparation could be undertaken by the insolvency representative who was usually independent and would bring an objective viewpoint to the task, one that was not necessarily dictated by the debtor or the creditors. It was noted, however, that preparation of the plan by the insolvency representative would rarely occur without consultation with interested parties. Another view was that a distinction needed to be drawn between the secured creditor model where an insolvency representative was appointed and could prepare the plan and the debtor in possession model where there would be an allocation of responsibility between the debtor and the creditors. What was required, it was suggested, was a balance between the freedom accorded to the parties to prepare the plan and the restraints that necessarily attached to the process in the form of voting requirements, time limits for preparation of the plan, amendment of the plan and other procedural considerations.

134. After discussion, the Working Group agreed that a flexible approach should be adopted on the question of who should prepare the plan. In some cases it might be appropriate for the debtor or its representative to prepare the plan and be given an exclusive period to do so on the basis that that might operate as an incentive to the debtor to commence proceedings at an early stage. That incentive would have to be balanced against the need to ensure creditor confidence in the debtor and its proposal. In other cases, the creditors' committee or an individual creditor could prepare the plan, while a third option would be to allow an insolvency representative to prepare the plan.

135. On the issue of the time at which the plan should be prepared, one view was that it should not be at commencement as that was not likely to be a plan of substance and may operate to pre-empt proceedings and cause delay. Another view was that it should occur in the observation period after commencement. A further view was that preparation of the plan might take place before the insolvency application. After discussion, it was agreed that the Guide should reflect an approach where there was no requirement for the plan to be prepared before commencement, but that that option should be available.

(ii) Content

136. The general view was that the plan needed to provide certain minimum information in order to ensure transparency and confidence in the process. It was suggested that there was a need for the goal of transparency to be weighed against confidentiality concerns arising from creditor access to potentially sensitive commercial information; it was noted that in cases where the plan was approved by the court, that information would generally

be on the public record at some stage of the proceedings, but that consideration should be given by the court to protecting confidential information. It was suggested that the information to be included in the plan should include statements on the financial situation of the debtor, including both asset and liability and cash flow statements; details of the precise proposals included in the plan; details of what creditors would receive and how that would be more than they would otherwise receive in liquidation; and the basis on which the business would be able to keep trading and could be successfully reorganized. It was observed that the plan could not provide for any action that would be illegal or contrary to law as noted in paragraph 176 of document A/CN.9/WG.V/WP.54/Add.1, with an additional example being cited of tax laws. However, it was also noted that there might be laws that could impede implementation of the proposals that might potentially be contained in the plan, with one example being laws on foreign direct investment or foreign exchange limitations. Since some insolvency laws allowed those provisions to be overruled in certain circumstances, or provided for fast-track approvals, it was suggested that the draft Guide should raise that issue for consideration. A further suggestion was that a number of the procedural issues set forth in italics on page 44 of document A/CN.9/WG.V/WP.54/Add.1 were issues that could be addressed in the plan to ensure that the procedures to be followed in order to achieve approval and implementation of the plan were clear.

137. It was noted that permitting secured creditor rights to be affected by the plan could have a negative impact upon the availability of credit and that that effect should be clearly stated in the draft Guide.

138. In terms of protection of minority interests, a question was raised as to whether that issue should be addressed in the plan or in the insolvency law. It was suggested that in order to ensure that the proceedings would be respected it was important that the majority creditors should not be able to unfairly affect the rights of the minority.

(iii) Approval and effect of the plan

139. On the issue of voting on the plan, a view was expressed that in order to encourage cross-border flows of capital clear rules were required as to the rights of the different classes of creditors, particularly with regard to the ability of creditors to vote on a plan and to refuse to agree to a plan. It was suggested that voting should be based only upon economic interest in the outcome of the process and that only those parties having such an interest should be permitted to vote. Support was expressed in favour of voting on the basis of both value of the claims and number of creditors, as well as for the requirement of a supermajority to ensure that the support for the plan was sufficient to ensure its implementation. This was expressed to be particularly important where dissenting creditors could be bound to the plan.

140. With regard to the reasons that creditors could put forward for challenging a plan, it was noted that since all creditors would be prejudiced by the proceedings, a level of prejudice or harm that exceeded the prejudice or harm suffered by other creditors or classes of creditors was required.

141. In terms of dividing creditors into classes and the criteria that should be taken into account, it was suggested that in the absence of a compelling reason for creating special classes, all general unsecured creditors should be treated in one class. It was noted, however, that in one country the law provided criteria for including secured claims in the same class if the interests of the creditors holding those claims were sufficiently similar

to give them a commonality of interest, taking into account factors including: the nature of the debts giving rise to the claims; the nature and priority of the security in respect of the claims; the remedies available to the creditors in the absence of the proposal, and the extent to which the creditors could recover their claims by exercising those remedies; the treatment of the claims under the proposal and the extent to which the claims would be paid under the proposal; and other criteria as may be prescribed.

142. It was suggested that the draft Guide should address the question of what occurred in situations where a plan was not approved and whether that would lead to other parties being able to propose an alternative plan, automatic commencement of liquidation proceedings, individual actions by creditors or some other result. One view was that a result of automatic liquidation might have the effect of discouraging the debtor from proposing a plan, an outcome that directly opposed to one of the key objectives of an insolvency regime. Another view was that allowing individual creditors to take action could result in the race for assets that the commencement of collective proceedings was intended to avoid and was incompatible with the goal of maximization of value. A different view was that once a plan was rejected, anything other than automatic liquidation might simply lead to delay, further diminution of value and no predictable end to the proceedings. Automatic liquidation would provide a procedure for equality of distribution in accordance with the insolvency regime. It was suggested that a compromise might be to allow the proposal of a different plan by creditors within a specified deadline and only in situations where no plan could be prepared should liquidation follow.

143. With respect to the approval procedure, it was noted that not all countries required court confirmation of a plan approved by creditors; some insolvency regimes provided that where the requisite majority of creditors had approved the plan nothing further was required. It was noted also that in some countries the role of the court was performed by an administrative authority. Minority creditors could be protected by allowing them to dispute the plan in court, with some laws establishing criteria against which the dissent of those creditors could be judged.

5. Liquidation and distribution

Distribution priorities

144. A general view was that the draft Guide should recommend that priorities in distribution should be not only clearly identified but also reduced to the minimum possible, with a view to both preserving the predictability and the efficiency of the insolvency system and to fostering the availability of credit. It was pointed out that the greater the number of priorities recognized by the law, the wider the scope of the debates which were likely to arise in assessing the privileges pertaining to the different privileged categories. Nevertheless, it was also suggested that the treatment of priorities should distinguish between those that might arise in respect of secured creditors as a result of a bargain or after commencement (such as would relate to provision of post-commencement finance) and those that were related to general unsecured creditors.

145. The Working Group agreed that the draft Guide should recommend that any priority be specifically mentioned in the insolvency law, irrespective of whether the policy reason underlying that priority was to be found in the insolvency system or in other legislation. It was also agreed that it would be inappropriate for the draft Guide to suggest which priorities should be retained or excluded. It was further agreed that the

financial and economic impact of introducing priorities (namely, the reduction of the amount of the estate available to unsecured debt) should be expressly mentioned.

146. With respect to the provision of a general superpriority, as such prevailing on both secured and unsecured creditors, the view was shared that such a priority would entail a major interference with the rights of secured creditors and therefore needed to be supported by sound public policy considerations.

147. The Working Group discussed the treatment of the expenses incurred during the insolvency proceeding. It was pointed out that most legal systems gave those claims a top priority by considering them to be administrative claims, often resulting in a significant impact on the insolvency estate. While it was recognized that the specific treatment of that issue had links to the underlying infrastructure of the system, various views to the effect of reducing the impact of those claims on the insolvency estate were expressed. The suggestion to introduce a ceiling to the amount of those expenses was not supported. Instead, the prevailing view was that precise, though flexible, criteria supporting allowance of those expenses should be outlined. In particular, it was suggested that their allowance should be conditional upon the utility of the expense for the purpose of increasing the estate in the general interest of all constituents. A similar suggestion was that those expenses should be allowed only when they appeared not only reasonable and necessary, but also consistent with the objectives of the procedure. A further suggestion was that the reasonableness of the expense should be assessed against both the amount of resources available to, and the possible effect on, the procedure.

148. As to the authority that should be entrusted with the task of assessing the appropriateness and reasonableness of the expenditure, one view was that those expenses needed to be subject to prior authorization by the court. According to a similar view, prior authorization by the court should be required in respect of actions falling outside the scope of the ordinary course of business. However, the prevailing view was that that assessment should be made by the creditors, with a view also to ensuring the transparency of the proceeding, provided however that the decision of the creditors would be subject to recourse to court.

149. In response to those suggestions, it was clarified that a distinction should be drawn between the fees of the insolvency representative and of other professionals involved in the procedure, on the one hand, and the expenses incurred for the purposes of operating the business and carrying out the procedure, on the other hand.

150. As a general suggestion, it was noted that the draft Guide should address the treatment of situations where limited or no assets were available. It was observed that different approaches were available: while some systems provided for immediate termination of the procedure upon assessment of absence of assets by the court, others provided that no action should be taken and others for a state liquidator to be appointed. It was suggested that in those cases the fees of the insolvency representative might be paid by way of a deduction on its personal tax account. In response, it was noted that that suggestion would result in the fees of the insolvency representative being borne by the State rather than by the insolvency estate. The view that, when a relevant tax credit was at stake, the tax authorities should be entrusted with the task of administering the insolvency proceeding was equally not supported.

151. As to the order in which issues were dealt with in the draft Guide, it was suggested that administrative claims should be addressed prior to secured creditors, given the status

of priority widely recognized as applicable to those claims. In response, it was observed that some legal systems might take a different view and that therefore the order of the text should not be amended.

152. Another suggestion was that reference to the "owners", as appearing in paragraph 195 of document A/CN.9/WG.V/WP.54/Add.1, be replaced by reference to the "shareholders". In response, it was observed that reference to shareholders would only reflect the situation of a debtor established in the form of a limited liability company and that a broader, more neutral term was needed to encompass all situations of financing granted by insiders.

153. In respect of the privilege granted to employee salaries and benefits, it was observed that providing for a system of social guarantee would result in a benefit for the insolvency estate, since that would allow those claims to be excluded from the distribution of the assets. It was however clarified that that would require that the social institution guaranteeing those claims would not be allowed to have the same priority vis-à-vis the insolvency estate as the employees. Another view was that the draft Guide should draw attention to solutions available in different legal systems.

154. A view was that priority of secured creditors, though established by substantive law, should be mentioned in the section of the insolvency law devoted to priority issues, since that would provide clarification for those legal systems where stability and confidence of the credit industry needed to be enhanced.

155. General support was expressed for the suggestion that the draft Guide should specifically address the issue of the termination of the proceedings, in respect of determining both the time at which it would occur and its effects.

IV. Alternative informal insolvency processes

156. The Working Group considered document A/CN.9/WG.V/WP.55 and what further work it might undertake in the area of informal insolvency procedures, taking into account the work of other organizations on that topic and international trends in the development of informal procedures that provided alternatives to formal procedures and were particularly useful in international insolvencies.

157. The Working Group generally agreed on the desirability of undertaking work on informal insolvency procedures, noting that while such procedures relied upon the formal insolvency framework they could provide a means of introducing flexibility into insolvency systems, reduce reliance on judicial infrastructure, facilitate an earlier pro-active response from creditors than would normally be possible under formal regimes and avoid the stigma that often attached to insolvency. It was noted that the increasing globalization of markets and the growth in debt trading had resulted in a more diverse range of creditors being involved in international reorganizations than previously. Those diverse creditors had different interests and objectives in the insolvency of the debtor, which did not always coincide with the interests and objectives of other major credit providers or support the achievement of reorganization.

158. The Working Group discussed the various forms that those informal proceedings could take. It was pointed out that there was a continuum of processes ranging from

non-binding principles which supported a collective negotiating framework and did not involve the judicial system (although relying on the existence of an efficient and effective formal system for leverage), to those which utilized a judicial administration mechanism to enforce a plan reached by informal negotiations and bind creditors to that plan. It was suggested that where the negotiations took place out of court and the debtor and the majority of creditors agreed to the plan, a fast track mechanism could be used for the approval process.

159. With respect to the completely informal processes, it was suggested that the Working Group should consider the work being undertaken by other organizations, such the INSOL Lenders Group's Statement of Principles for a global approach to multi-creditor workouts (set forth in document A/CN.9/WG.V/WP.55) and other similar types of guidelines. In regard to those processes that combined informal and formal elements, the Working Group might consider how those processes had been developed around the world and in particular examine the role that was taken by judicial and administrative authorities and the point at which intervention occurred.

160. With regard to administrative frameworks, three types of experience were noted and it was suggested that the draft Guide should consider the relevant examples and the circumstances in which they had proven to be useful and where they might appropriately be used in the future. In particular, it was pointed out that they had been of assistance in situations where the courts were inadequate to deal with the issues or simply overwhelmed by the extent of systemic failure.

161. It was noted that some of those considerations intersected with the Working Group's development of a legislative guide on a formal insolvency regime and consideration would need to be given to how that intersection could be achieved. In particular, it was suggested that the draft Guide should consider the different options, offering a discussion of the advantages and disadvantages of each and indicating how they could be integrated into a reorganization regime. It was noted in that regard that there was a correlation between the degree of financial difficulty being experienced by the debtor and the difficulty of the appropriate solution. Where, for example, a single bank was involved, it was likely that the debtor could negotiate informally with that bank and resolve its difficulties without involving trade creditors. Where the financial situation was more complex and required the involvement of a large number of different types of creditors, a greater degree of formality might be needed. It was suggested that that approach might be a way of presenting the different procedures to legislators. It was agreed that those considerations should be taken into account in the Working Group's consideration of the reorganization sections of the draft Guide, and in particular that the subject of expedited reorganization procedures to implement restructurings of the type addressed in document A/CN.9/WG.V/WP.55 (including both cross-border and domestic arrangements) be addressed in the draft Guide.