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Report of Working Group V (Insolvency Law) on the work of its thirty-ninth session

(Vienna, 6-10 December 2010)

Contents

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I. Introduction

1. At its forty-third session in 2010, the Commission had before it a series of proposals for future work on insolvency law (A/CN.9/WG.V/WP.93 and Add.1-6 and A/CN.9/582/Add.6). Those proposals had been discussed at the thirty-eighth session of Working Group V (see A/CN.9/691, paras. 99-107) and a recommendation on potential topics made to the Commission (A/CN.9/691, para. 104). An additional document (A/CN.9/709), submitted after that session of Working Group V, set forth material additional to the proposal of Switzerland contained in A/CN.9/WG.V/WP.93/Add.5.

2. After discussion, the Commission endorsed the recommendation by Working Group V that activity be initiated on two insolvency topics: (a) Interpretation and application of selected concepts of the UNCITRAL Model Law on Cross-Border Insolvency relating to centre of main interests; (b) Directors' responsibilities and liabilities in insolvency and pre-insolvency cases, both of which were of current importance; and (c) Judicial materials on the UNCITRAL Model Law on Cross-Border Insolvency.

II. Organization of the session

3. Working Group V (Insolvency Law), which was composed of all States members of the Commission, held its thirty-ninth session in Vienna from 6 to 10 December 2010. The session was attended by representatives of the following States members of the Working Group: Argentina, Australia, Austria, Belarus, Canada, China, Colombia, Czech Republic, Egypt, El Salvador, France, Germany, Greece, Iran (Islamic Republic of), Israel, Italy, Japan, Malaysia, Mexico, Namibia, Philippines, Republic of Korea, Russian Federation, Spain, Thailand, Turkey, Uganda, United Kingdom of Great Britain and Northern Ireland, United States of America and Venezuela (Bolivarian Republic of).

4. The session was also attended by observers from the following States: Belgium, Croatia, Democratic Republic of the Congo, Denmark, Indonesia, Lithuania, Netherlands, New Zealand, Romania, Slovakia, Slovenia, Switzerland and Tunisia.

5. The session was also attended by observers from the following international organizations:

(a) *Organizations of the United Nations system*: International Monetary Fund (IMF) and the World Bank;

(b) *Invited intergovernmental organizations*: European Union (EU), Interparliamentary Assembly of Member Nations of The Commonwealth of Independent States (CIS) and the Caribbean Community (CARICOM);

(c) *Invited international non-governmental organizations*: Alumni Association of The Willem C. Vis International Commercial Arbitration Moot (MAA), American Bar Association (ABA), Asian Clearing Union (ACU), Center For International Legal Studies (CILS), Groupe de réflexion sur l' insolvabilité et sa prévention (GRIP 21), INSOL International (INSOL), International Bar Association (IBA), International Credit Insurance and Surety Association (ICISA), International

Insolvency Institute (III), International Law Institute (ILI), International Swaps and Derivatives Association (ISDA), International Women's Insolvency and Restructuring Confederation (IWIRC) and Union Internationale des Avocats (UIA).

6. The Working Group elected the following officers:

Chairman: Mr. Wisit Wisitsora-At (Thailand)

Rapporteur: Mr. Anthony Ojok Oyuko (Uganda)

7. The Working Group had before it the following documents:

(a) Annotated provisional agenda (A/CN.9/WG.V/WP.94);

(b) A note by the Secretariat on Interpretation and application of selected concepts of the UNCITRAL Model Law on Cross-Border Insolvency relating to centre of main interests (A/CN.9/WG.V/WP.95 and Add.1);

(c) A note by the Secretariat on Directors' responsibilities and liabilities in insolvency and pre-insolvency cases (A/CN.9/WG.V/WP.96); and

(d) A note by the Secretariat on judicial materials on the UNCITRAL Model Law on Cross-Border Insolvency (A/CN.9/WG.V/WP.97 and Add.1-2).

8. The Working Group adopted the following agenda:

1. Opening of the session.
2. Election of officers.
3. Adoption of the agenda.
4. Consideration of (a) the interpretation and application of selected concepts of the UNCITRAL Model Law on Cross-Border Insolvency relating to centre of main interests; (b) directors' responsibilities and liabilities in insolvency and pre-insolvency cases; and (c) judicial materials addressing the use and interpretation of the UNCITRAL Model Law on Cross-Border Insolvency.
5. Other business.
6. Adoption of the report.

III. Deliberations and decisions

9. The Working Group engaged in discussions on: (a) the provision of guidance on interpretation and application of selected concepts of the UNCITRAL Model Law on Cross-Border Insolvency relating to centre of main interests; (b) directors' responsibilities and liabilities in insolvency and pre-insolvency cases; and (c) the production of judicial materials addressing the use and interpretation of the UNCITRAL Model Law on Cross-Border Insolvency on the basis of documents A/CN.9/WG.V/WP.95, A/CN.9/WG.V/WP.96 and A/CN.9/WG.V/WP.97, their Addenda and other documents referred to therein. The deliberations and decisions of the Working Group on those topics are reflected below.

IV. Interpretation and application of selected concepts of the UNCITRAL Model Law on Cross-Border Insolvency relating to centre of main interests (COMI)

10. The Working Group discussed selected concepts of the UNCITRAL Model Law on Cross-Border Insolvency (the "Model Law") in relation to centre of main interests (COMI) on the basis of documents A/CN.9/WG.V/WP.95 and Add.1.

A. General discussion

11. The Working Group recalled that the mandate given by the Commission with respect to the topic concerning the interpretation and application of selected concepts of the Model Law relating to COMI was based on the "United States' proposal as described in paragraph 8 of document A/CN.9/WG.V/WP.93/Add.1 to provide guidance on the interpretation and application of selected concepts of the UNCITRAL Model Insolvency Law relating to centre of main interests and possibly to develop a model law or provisions on insolvency law addressing selected international issues, including jurisdiction, access and recognition, in a manner that would not preclude the development of a convention".[1] In that regard, it was clarified that such future work was not intended to modify the already existing UNCITRAL standards with respect to insolvency and the concepts included therein, but to clarify their meaning.

12. It was observed that certain concepts of the Model Law relating to COMI and the concept of COMI itself had raised issues of interpretation, resulting in diverging court decisions (see documents A/CN.9/WG.V/WP.95 and Add.1).

13. The question was raised whether the Working Group should embark on a discussion of the various types of text of uniform law that could be developed to provide guidance on the different concepts. The various types of texts of uniform law could be (i) rules, (ii) recommendations or (iii) commentary/guidelines on selected topics of the Model Law. In response, it was recalled that the Working Group had in the past left considerations of form to be decided after the debate on substantive issues. It was generally felt that the same approach should also be taken with the future work on clarifying concepts of the Model Law.

14. With respect to clarifying the concept of COMI as contained in the Model Law, it was noted that, though the concept appeared in various articles of the Model Law, such as articles 2 (b), 16 (3) and 17 (2) (a), the Model Law did not contain any definition of it. As an example of a text developed on the same topic by a regional economic integration organization, it was pointed out that the European Council (EC) Regulation No. 1346/2000 of 29 May 2000 on insolvency proceedings (the "EC Regulation") also referred to the notion of COMI without providing any definition. It was pointed out that, in view of the importance of that notion, it was desirable to avoid inconsistent interpretation in its use. It was observed, however, that the notion of COMI might be used in different contexts, for example, under the EC Regulation, in relation to the jurisdiction in which main proceedings should be

[1] *Official Records of the General Assembly, Sixty-fifth Session, Supplement No. 17* (A/65/17), para. 259 (a).

commenced and, under the Model Law, in relation to the appropriateness of recognition of an already commenced proceeding. It was also noted that it would be desirable for the future work to be undertaken to include further elaboration regarding how to determine COMI of an enterprise group.

15. Acknowledging the diverse and conflicting case law relating to COMI, it was generally felt that clarifying the concept of COMI could be useful for practitioners and courts. It was further noted that it might be difficult to provide a concrete definition for the concept of COMI, but that there were several ways of providing clarification including providing a list of factors to be considered for the determination of COMI with a view to providing greater uniformity and predictability.

16. It was further noted that other terms included in the Model Law such as the elements of the definition of foreign proceeding and the issue of the point in time the COMI of a debtor was evaluated were connected to the terms of COMI, and it was agreed that it would be beneficial to first consider those other factors and then to commence consideration of the concept of COMI.

B. Proceedings qualifying for recognition under the Model Law: article 2

Issues with respect to the definition of a "foreign proceeding" pursuant to article 2 (a) of the Model Law

17. It was noted that the definition included in article 2 (a) of the Model Law of a "foreign proceeding" had given rise to diverse interpretation in case law (see A/CN.9/WG.V/WP.95, paras. 8-37). The question was raised whether the Working Group should consider providing clarity on the definition of certain elements of a foreign proceeding pursuant to article 2 (a) of the Model Law, which states that "foreign proceeding means a collective judicial or administrative proceeding in a foreign State, including an interim proceeding, pursuant to a law relating to insolvency in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganization or liquidation".

18. In that regard, it was questioned whether there was a need to define the requirement of the insolvency of the debtor. In response, it was said that such definition was not needed, as the requirement of the insolvency of the debtor would flow from the terms "pursuant to a law relating to insolvency".

19. With respect to the need of providing a definition for the terms "pursuant to a law relating to insolvency", it was felt that difficulties in judicial interpretations of those terms had resulted from equating terminology of legislation of different jurisdictions. It was noted that the Working Group did not aim for unification of insolvency laws, but to provide clarity on concepts in the Model Law. In that respect, it was said that it would be impossible to further detail the definition of a "foreign proceeding" that would still capture all domestic proceedings. It was further noted that the notion of "a law relating to insolvency" already provided the desirable degree of flexibility. It was also noted that the UNCITRAL Legislative Guide on Insolvency Law (the "Legislative Guide") provided for a definition of

insolvency proceedings in paragraph 12 (u) and accompanying commentary, which was consistent with the definition included in the Model Law.

20. The Working Group noted that the Guide to Enactment of the Model Law stated that the requirement of a "collective proceeding" referred to the involvement of creditors collectively in the foreign proceeding, rather than that the proceeding was designed to assist a particular creditor to obtain payment. With respect to the requirement of "collective proceedings", it was said such requirement was an important element of the definition. It was noted that there might be some domestic proceedings where that requirement could technically be questioned as not fully satisfied, but that the proceedings had been nevertheless recognized under the Model Law. In that respect, the need for flexibility of a definition in the Model Law on a foreign proceeding was again emphasized. The concern was further expressed that establishing further criteria of what constituted a foreign proceeding would be unnecessarily restrictive.

21. It was suggested that the Secretariat could identify some proceedings that did not clearly fall into the definition of article 2 (a) of the Model Law or which inclusion could or had already given rise to concerns (referred to in the discussion as "grey area"), in order to facilitate the Working Group's consideration on whether clarification of the definition of "foreign proceeding" was needed. The utility of such study was questioned on the basis that such study would be a study of the current situation not capturing new circumstances and not taking into account that the concept of "a law relating to insolvency" was very broad.

22. After discussion, the Working Group agreed that, at that point of its deliberations, it was premature to state whether the definition of "foreign proceeding" pursuant to article 2 (a) of the Model Law needed clarification. The Working Group requested the Secretariat to prepare an informative note to assist its consideration of that matter at a future session.

C. Uniform interpretation and international origin: article 8 of the Model Law

23. The Working Group noted that article 8 of the Model Law provided that in interpreting the text, regard was to be had to its international origin and the desirability of promoting uniformity in its application and the observance of good faith. The Working Group considered whether further guidance should be provided on the sources to be used to provide assistance on interpretation of the Model Law under article 8 (see document A/CN.9/WG.V/WP.95, paras. 40-42).

24. It was noted that jurisprudence on the Model Law was important for the uniform interpretation pursuant to article 8 and that the Guide to Enactment of the Model Law referred to the facilitation of such harmonized interpretation (see Guide to Enactment of the Model Law, para. 92) by the Case Law on UNCITRAL Texts (CLOUT) information system, under which the UNCITRAL secretariat published abstracts of judicial decisions that interpret conventions and model laws emanating from UNCITRAL. In that respect it was noted that UNCITRAL texts other than the Model Law (including the Legislative Guide) would also be of assistance for such interpretation. It was further said that jurisprudence on the interpretation of the Model Law had also included references to cases relating to other than UNCITRAL

texts, such as cases dealing with the EC Insolvency Regulation, which also includes the concept of COMI (see paragraph 14 above).

25. After discussion, it was generally viewed that there was no need to provide further clarification on article 8 of the Model Law.

D. Recognition

1. Public policy exception: article 6 of the Model Law

26. The Working Group noted that article 6 of the Model Law provided an exception to recognition of a foreign proceeding where to do so would be "manifestly contrary to the public policy" of the receiving State. The Working Group further noted that the Guide to Enactment indicated that exception should generally be interpreted restrictively and that it was only intended to apply in exceptional circumstances concerning matters of fundamental importance to the enacting State.

27. The Working Group considered whether there was a need to provide clarification on the public policy exception. It was questioned whether forum shopping should be included in the exception. In response, it was viewed as appropriate to deal with forum shopping with respect to the determination of COMI itself, as the public policy exception was to be narrowly applied.

28. One delegation informed the Working Group on its domestic enactment of the Model Law which required a governmental body to be informed and given the opportunity to intervene once the public policy exception was raised, in order to discourage its being raised frivolously. Some views were expressed that clarification of the exception could be useful to counter potential abuse, in particular as not all domestic enactments possessed such a provision. It was said that it might be difficult to define the public policy exception, as it was viewed as a matter of domestic law differing from jurisdiction to jurisdiction.

29. In response, different suggestions were made to counter improper invocation of the public policy exception. It was suggested that a reference could be made to the "exceptional nature" of the public policy exception. It was also suggested that a reference to article 8 on the interpretation of the Model Law and to the cases collected in CLOUT (see paragraph 24 above) would suffice. It was further said that the Guide to Enactment already provided adequate explanation on the sensitivity of applying the public policy exception. It was also said that article 22 of the Model Law provided sufficient protection of creditors and other interested persons. A different view expressed was that the Secretariat could be asked to provide a list of examples of application of the public policy exception. In response, it was said that providing examples could raise difficulties, as those examples were based on cases with particular facts requiring further guidance. In addition, it was said that providing examples would require an assessment on the value of such cases by the Working Group.

30. After discussion, the Working Group agreed that the public policy exception was a matter of national law to be decided by national courts. The Working Group further agreed that the exception should be narrowly applied, but did not take a decision on how to ensure such restricted application at that stage of its discussion,

agreeing to give further consideration to that issue when discussing the judicial materials on the Model Law contained in document A/CN.9/WG.V/WP.97 and its addenda.

2. Decision to recognize a foreign proceeding under article 17 as main or non-main proceeding pursuant to article 2 (b) and (c) of the Model Law

31. It was noted that it was not the wording of the Model Law that had given rise to difficulties, but rather its application in the area of recognition. It was further noted that many national enactments of the Model Law were of a rather recent nature, so that its application had sometimes caused uncertainties with case law just developing. It was also noted that article 17 of the Model Law laid down the procedure for recognition, separated from whether and what relief would be accorded, pursuant to articles 19 and 21 of the Model Law.

(a) Precondition for recognition: main or non-main proceeding

32. The Working Group noted that article 17 (2) (a) of the Model Law provided that a foreign proceeding within the meaning of article 2 (a) should be recognized as either a main (where the debtor's COMI was) or non-main foreign proceeding (article 2 (b) or (c)). The Working Group then considered whether a court must be satisfied that a proceeding under the Model Law was either a foreign main or non-main proceeding, as a pre-condition for recognition.

33. The view was expressed that that question had been sufficiently addressed by the decision in the *Bear Stearns* case,[2] requiring such determination as a necessary pre-condition for recognition.

34. It was questioned whether there should also be a third category of proceedings or, to the same end, an expansion of the concept of "establishment" contained in article 2 (f) of the Model Law to capture proceedings on the basis of location of assets in a State and reference was made to article 28 of the Model Law. In response, it was said such expansion would result in a modification of the Model Law outside of the Working Group's mandate for its current work and contrary to the spirit of the Model Law. It was noted that the Model Law left sufficient discretion to domestic law to allow the opening of domestic proceedings on other grounds.

35. After discussion, the Working Group agreed that the Model Law clearly provided for recognition of only two types of proceedings, foreign main and non-main proceeding.

(b) Procedure to establish determination of main or non-main proceeding

36. It was suggested to include either in the initial court order opening the proceedings or as additional evidence submitted pursuant to article 15 (2) (c), factual information regarding whether the proceeding was a main or non-main proceeding within the meaning of the Model Law, to assist the determination of

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[2] Bear Stearns Hi-Grade Structured Credit Strategies Master Fund Ltd. 374 B.R. 122 (Bankr. S.D.N.Y. Sep 2007); [CLOUT case No. 760]; A/CN.9/WG.V/WP.93/Add.2, paras. 45-48; Bear Stearns (on appeal) 389 B.R. 325 (S.D.N.Y. May 2008); [CLOUT case No. 794]; A/CN.9/WG.V/W, paras. 45-48; see also document A/CN.9/WG.V/WP.95/Add.1, Annex.

foreign main or non-main proceeding by a court which might decide on an application for recognition at a later stage. In that respect, it was noted that article 15 of the Model Law already specified the documents which should accompany an application for recognition. With respect to a concern that the proposal would disadvantage proceedings under the supervision of an authority other than a court, it was recalled that the notion of "court" used in the Model Law also included a judicial or other authority competent to control or supervise a foreign proceeding pursuant to article 2 (e) of the Model Law. Another concern was that the court deciding on the opening of the proceedings might not be aware of the necessity for such inclusion.

37. After discussion, the Working Group agreed that it would provide useful assistance if a court opening the proceedings would include in its order information as proposed above and further agreed to contain that point in its final work product.

3. Location of COMI: article 16 presumption

38. The Working Group noted that article 16 (3) of the Model Law established a presumption upon which the court was entitled to rely in determining COMI, which provided that, in the absence of proof to the contrary, the debtor's registered office (or habitual residence in the case of an individual) was presumed to be the centre of its main interests. The Working Group further noted that paragraph 122 of the Guide to Enactment of the Model Law indicated that the purpose for that presumption was to expedite the evidentiary process. The Working Group also noted that a number of cases had raised issues concerning the location of the COMI and the interpretation of the presumption in article 16 (3) (see document A/CN.9/WG.V/WP.95/Add.1, paragraphs 5-20). The Working Group considered whether a list of indicative factors for the COMI should be established with relation to rebutting the presumption.

(a) Development of a list of indicative factors

39. Different views were expressed on the weight that the various factors listed in paragraph 20 of document A/CN.9/WG.V/WP.95/Add.1 ought to have in such COMI analysis. In particular, some viewed the factors included in subparagraphs (a) to (g) and (m) as fundamental to the COMI analysis, whereas others regarded "the site of the controlling law or to the law governing the main contracts of the company" (subparagraph (d)) as secondary or "the location from which financing was organized or authorized or the location of the debtor's primary bank" (subparagraph (f)) as not appropriate unless the bank controlled the debtor company. Some viewed the "location of employees" (subparagraph (k)) as crucial on the basis that the employees might be future creditors, whereas others viewed that matter to be a question of protection of rights of interested parties, not relevant to the COMI analysis and as sufficiently addressed by article 22 of the Model Law. Views further varied on the factors of "the location from which reorganization of the debtor was being conducted" (subparagraph (l)) and "the location in which and whose law governed the preparation and audit of accounts" (subparagraph (o)), with respect to the latter, it was noted that the company could be audited in different States.

40. It was also suggested to prioritize the factors in the list and to keep it as short as possible. In response, it was said that prioritizing was difficult, as the evaluation might differ from jurisdiction to jurisdiction and that shortening the list might be misleading. A concern was expressed with respect to the term "list", as it might

convey a mandatory nature. In response, the Working Group was recalled of the purpose for the list, which was to assist judges in their analysis on objective criteria to determine COMI to find the appropriate forum. It was also noted that all criteria were based on the concept of a "sufficient connection" to the State to be subject to its insolvency laws, a concept that was also referred to as a basis for jurisdiction in the Legislative Guide, Part two, Chapter I, paragraph 12.

41. After discussion, the Working Group agreed that a list of indicative factors would assist judges in their COMI analysis.

(b) Impact of fraud on the factors to be considered in determining COMI

42. The Working Group considered the impact of the incidence of fraud on the factors to be considered in determining COMI. Questions were raised with respect to the definition of fraud. It was said that it could refer to a company which engaged in fraudulent activities or establishment of which was itself a fraud. It was further questioned whether the definition would include civil or criminal fraud. It was further questioned whether so-called "illegitimate" forum shopping where a debtor tried to find a more favourable jurisdiction to deter creditors would fall under the definition. Concerns were expressed that each jurisdiction had its own notion of fraud, which would be addressed in the public policy exception under article 6 of the Model Law.

43. After discussion, the Working Group agreed that that issue would need further consideration.

(c) Time period for determination of COMI

44. The Working Group considered whether the COMI determination should be made as of the date of application for commencement of insolvency proceedings or as of the date of the application for recognition of those proceedings, as there had been a number of cases arising under both the Model Law and the EC Regulation involving a debtor moving from one jurisdiction to another in close proximity to the commencement of insolvency proceedings. The Working Group noted that the Model Law did not make any mention of timing with respect to the determination of COMI (see A/CN.9/WG.V/WP. 95/Add.1, paragraphs 26-36). It was said that using the time of recognition could lead to unfair results and would be contrary to the spirit of the Model Law, in particular as many years might have passed between the date of commencement and of application for recognition. In that regard, the view was expressed that the time period chosen for that determination should provide stability.

45. After discussion, the Working Group agreed that the relevant time period for determination of COMI should be the date of the initial application for commencement of insolvency proceedings and that that conclusion would be included in the final work product, which might be an amendment of the judicial material on the Model Law contained in document A/CN.9/WG.V/WP. 97 and its addenda.

4. Establishment

46. The Working Group considered the question whether the concept of "establishment" defined in article 2 (f) of the Model Law and relevant for the

determination of a non-main proceeding required clarification. After discussion, the Working Group agreed that the concept of establishment did not need clarification, either with respect to a company or an individual debtor.

5. COMI of an enterprise group

47. It was noted that many cases under the Model Law involved enterprise groups and that it might be beneficial to also provide guidance on the interpretation of COMI in the Model Law of an enterprise group.

48. After discussion, the Working Group agreed to request the Secretariat, resources permitting, to prepare a study on COMI of enterprise groups for its consideration at a future session, including (i) discussion during its previous work on part three of the Legislative Guide, (ii) existing practice with enterprise groups, and, so far as possible, (iii) suggestions on how far future work might go.

V. Directors' responsibilities and liabilities in insolvency and pre-insolvency cases

49. The Working Group discussed the responsibility and liability of directors and officers of an enterprise in insolvency and in pre-insolvency on the basis of documents A/CN.9/WG.V/WP.96 and other documents referred to therein.

50. The Working Group recalled the mandate of the Commission that the work on that topic should focus upon those responsibilities and liabilities that arose in the context of insolvency, and that it was not intended to cover areas of criminal liability or to deal with corporate issues outside the context of insolvency (A/65/17, para 259 (b)).

A. Introduction

1. General remarks

51. The original proposals from the United Kingdom, INSOL international and the International Insolvency Institute, set out in documents A/CN.9/WG.V/WP.93/Add.3, A/CN.9/WG.V/WP.93/Add.4 and A/CN.9/582/Add.6, were recalled, and the proponents outlined the issues raised.

52. It was noted that where an enterprise might be approaching insolvency, abuse on the part of directors had been observed, such as transactions detrimental to the company and/or its creditors, perhaps for the benefit of the director concerned, including putting assets put beyond the reach of creditors and future office-holders.

53. Several aspects of the topic were highlighted: whether there could be minimum standards that should govern directors' behaviour and guidance to encourage best practice; whether directors' duties would change with the approach of insolvency; how the cross-border context would affect such duties; and what the appropriate consequences for breach of duties might be.

54. The aim of the work on the topic was, it was said, to ensure that, where insolvency was already approaching, directors should take such action as would preserve the value of the company, perhaps via reorganization, rather than simply

waiting for the commencement of insolvency proceedings. While many systems encouraged reorganization as an important and constructive tool, it was insufficiently used in practice, often because of a lack of incentives. Directors were also generally not penalised for taking valuable assets from a failing company for future use. Thus the work on the topic would seek to provide incentives for taking appropriate action, balanced with consequences including personal liability where such action was not followed.

55. It was emphasized that the objective was to encourage directors to take appropriate and timely steps upon becoming aware that the company could not trade out of its difficulties, which might include seeking the early commencement of a suitable insolvency procedure. This encouragement should be balanced, it was said, against the risk of directors putting the business into liquidation prematurely (to avoid the risk of incurring personal liability) when a reorganization procedure, given time to take effect, would give the best outcome. The need for a flexible approach, which would allow directors acting in good faith to take the most appropriate action, was noted.

56. It was observed that there were, as yet, no international standards on this question, though reference was made to post-insolvency duties and avoidance provisions in Recommendation 87 of the Legislative Guide; and it was recalled that the European Commission and World Bank had indicated the need for such standards. It was also emphasized that addressing this issue would enhance the objectives of the Model Law and the Legislative Guide.

57. The importance of considering the issue in the context of enterprise groups was also highlighted; one concern raised was that failure to do so might lead to one company within a group operating in a country with a restrictive regime being forced into premature liquidation, with a detrimental effect on the group as a whole.

58. The Working Group recalled a questionnaire issued by the International Insolvency Institute on the topic, and a detailed publication by INSOL with a country-by-country analysis, and it was observed that further studies of the current position throughout the world might assist in its future deliberations.

2. Features of possible work

59. The scope of possible work was considered in detail. While it was noted that there was no intention of addressing criminal liability, or matters of pure corporate governance, it was agreed that the intersection of those issues was a reality that had to be considered.

60. As regards the nexus between criminal and civil law questions, it was recalled that criminal sanctions or penalties were not in the Working Group's mandate. The difficulty of a complete separation in practice between these areas was highlighted. For example, compensation on civil claims might be left in abeyance until any criminal cases related to the insolvency concerned had been completed, as was the case in some jurisdictions. It was added that the Working Group would need to ensure that the scope of its work throughout its deliberations reflected the practical aspects of this interaction.

61. As regards the intersection of insolvency and company law, it was noted that directors' liabilities in general were an issue of corporate governance and so outside

the Working Group's mandate, and insolvency law should not extend into those areas. It was stressed that, absent insolvency, the duties of directors were owed to the company (which, in some systems, also meant to its shareholders); when insolvency approached or insolvency proceedings commenced, those duties might or would extend to creditors and other stakeholders; the interests of these groups might conflict (for example, the creditors might be best served by liquidation and distribution but the shareholders might wish to trade on so long as there was any hope of avoiding insolvency). In this regard, the critical period to consider when additional duties might arise would be prior to the commencement of insolvency proceedings.

62. As regards the eventual text or guidance to be issued, it was noted that the area was highly fact-specific and not readily amenable to rule-making, and hence the type of guidance to be produced would need to be descriptive rather than normative or prescriptive; expressions of principles would also avoid interfering with matters of corporate law. The need to avoid discouraging responsible risk-taking and enterprise was emphasized. Differences in the extent of directors' liabilities were highlighted and it was recalled that not all systems traditionally included a judicial review of evaluative assessments of this type.

63. It was added that a creditor might have remedies against directors, and enforcement action would be taken outside the insolvency proceedings. This aspect of the topic might fall outside the Working Group's mandate, strictly speaking, but the risk of such action (which might affect the estate) should nonetheless be borne in mind.

64. Other practical aspects of the topic were highlighted: first, the question of funding any action, even if it had reasonable prospects of success, had been noted to be a considerable impediment to enforcement in practice. Secondly, the beneficiaries of any recovered sums should be considered: where recovered moneys would accrue to secured creditors under an all-asset or all-enterprise security interest, rather than to the general body of creditors, there would be little or no incentive for an insolvency representative to act.

65. Private international law issues were also noted as important, both as regards jurisdiction and applicable law; it was agreed that harmonizing standards on these issues should make these questions easier to determine. In the light of these considerations, it was agreed that the cross-border context should be added to the aspects of the topic set out in paragraph 74 of A/CN.9/WG.V/WP.96 that the Working Group would consider.

66. It was recalled that, in discussing the issues to be considered and possible solutions, straying into areas of corporate law should not be automatically avoided. The need was to ensure that the ultimate results did not go beyond the context of insolvency or interfere in company or other civil or criminal law.

67. The Working Group agreed that these considerations indicated that guidance on the topic would be appropriate. It also heard suggestions on the various elements of the topic that might form the basis of guidelines or other guidance on this issue, based on the items listed in paragraph 74 of A/CN.9/WG.V/WP.96 (see section 3 below). The general importance of taking steps that might lead to an increase in the insolvency estate, where appropriate, was recalled.

3. Issues to be considered

(a) Defining the persons by whom the duties are owed

68. The first aspect raised was the need to identify who might owe such duties. The Working Group noted that the starting point would be formally appointed directors (and that a statutory definition of directors was the norm); the description set out in paragraphs 18-22 of A/CN.9/WG.V/WP.96, including the OECD (Organisation for Economic Co-operation and Development) principles, indicated how the group of possible individuals might be expanded.

69. Additional persons included de facto or shadow directors (those that acted as directors or that directed or otherwise controlled the company, or in accordance with whose instructions the company was accustomed to act); officers that had responsibilities related to the management of a company (which might include a chairman, auditors or general managers); boards of administration or directors in larger companies and enterprise groups, persons with decisive influence or dominance, and persons with ostensible authority to bind the company. The interaction between the identification of those that owed duties and the nature of the duties was noted in this regard.

70. In this context, the risks of limiting the duties to those formally appointed as directors were emphasized: among other things, so doing might encourage the use of nominees or "men of straw", so that the real decision-takers would be protected from any liability. Caution was urged, however, in that not all jurisdictions regulated the duties of directors other than formally appointed directors, at least in the period prior to insolvency.

71. It was generally accepted that directors for this purpose could be natural or legal persons. Legal persons might include other companies within an enterprise group, banks, consultants or other advisors, and auditors. While it was agreed that these entities might influence the company's actions, views differed as to whether their influence constituted management of the company, and as to whether such management was a prerequisite to any liability (that is, how the issue of causation would relate to the definition of those that owed relevant duties and to breaches of such duties). An important consideration was to identify the group of persons that might cause harm through some type of managerial action; harm might be caused in a subsidiary company through actions taken at the behest of a parent company. The possible differences between auditors, in particular, and other categories of persons were noted.

72. It was concluded that a purposive approach would be appropriate; national law would set out in a non-exhaustive fashion those with appropriate duties. Additional persons should be identified in a descriptive manner, based on the other persons to whom duties could be extended rather than a technical description of, for example de facto or shadow directors. It was agreed that future deliberations would be based on that approach, and it was recalled that the question of whether the group of persons should be expanded beyond directors to others with influence would be considered further.

(b) Identifying the persons to whom the duties are owed

73. It was observed that the persons to whom duties might be owed could be based on potential liability to all stakeholders, or to a defined group, such as the company, shareholders and/or creditors, or those that would benefit from any recovery made. The view was expressed that creditors in this sense should be interpreted as the general body of creditors rather than any particular creditor or group of creditors.

74. An alternative suggestion was that the duties should be considered as owing to the estate per se. In support of that suggestion, the existence of a well-accepted definition of the concept was recalled, which would include all persons to whom services or funds were owed, and the benefits of avoiding dealing with different classes of stakeholder were highlighted. This approach, it was said, would also be consistent with the objective of equal treatment of similarly-situated creditors (Recommendation 1 (d) of the Legislative Guide), and would involve a practical rather than a doctrinal approach, based on identifying the potential beneficiaries of any recovery action.

75. It was noted that directors should be presumed to act in good faith, so that the interests of the company coincided with those of shareholders, creditors and employees. Acting in bad faith might be actionable.

76. The interaction of this issue with the time at which duties arose was noted. The duties of directors of a solvent company were owed exclusively to that company and, it was recalled, should not be extended; where a company might be insolvent, the duties were owed to the estate and as such might be extended to shareholders and other stakeholders, whose interests would ultimately be represented by an insolvency representative.

77. The Working Group was invited to distinguish between the onset of insolvency as a matter of fact and the formal commencement of insolvency proceedings. In the period between these two events, those jurisdictions that recognized the concept of wrongful or insolvent trading equated the responsibility of formally-appointed directors and all other persons that held themselves out as acting in authority as regards the company, or that issued instructions or otherwise influenced the management of the company.

78. The importance of recognizing the scope and extent of duties that might arise in the concept of an enterprise group when identifying those responsible was highlighted, and that there might be different degrees of responsibility.

79. It was agreed that the Working Group would continue its deliberations at a future session on the basis of the issues set out above.

(c) Defining the time at which duties arise in the period before commencement of insolvency proceedings

80. It was agreed that the duties under consideration might arise before the commencement of formal insolvency proceedings. In this regard, the fact that this point in time and the factual onset of insolvency were rarely simultaneous was noted.

81. It was agreed that the duties would arise when the company was or would imminently become factually insolvent (practically speaking, when creditors' money

was put at real risk or when the company was at real risk, referred to in the discussion as the "vicinity of insolvency"), though the duties could be enforced only in the context of a formal insolvency proceeding. The timing therefore underscored the importance of the topic in supporting appropriate and timely action when companies became insolvent. In other words, the point in time at which the duties arose should be that point at which directors should have been aware that there was no reasonable prospect of avoiding insolvent liquidation.

(d) Specifying the nature of the duties owed or the types of misconduct to be covered, for example:

(i) Wrongful trading — where a director or officer ought to have known that insolvency was unavoidable and the director or officer has failed to take reasonable steps to minimize losses to creditors;

(ii) Breach of duty — where a director or officer has misapplied or retained money or property of the company or where a misfeasance or breach of duty, fiduciary or otherwise, has caused the misapplication of assets or a loss to the company; and

(iii) Misconduct involving company money or property — where a director or officer causes or allows a preference or a transaction at an undervalue to the detriment of creditors.

82. There was general agreement that the issue of the nature of the duties owed included consideration of who owned the duty (item 3 (a)), to whom (item 3 (b)), and what time (item 3 (c)).

83. As regards wrongful trading (paragraph (d) (i)), it was noted that some jurisdictions presumed fault associated with the insolvency in some certain circumstances. The experience of one country was shared: in an insolvency in which less than 20 per cent of the company's debts could be paid, liability on the part of directors was indicated, and courts could require a repayment from those directors into the estate. On the other hand, it was stressed that fault should not be presumed.

84. As regards the scope of the duties, caution was urged that imposing too tight a regime might discourage trade and entrepreneurship (contrary to the general mandate of UNCITRAL). Where there were external causes of insolvency, such as a general recession, directors exercising proper business judgment should not be penalized. Other views were that directors should be cognizant of trading conditions, though they might be relevant as defences to an eventual recovery action.

85. In this regard, it was stressed that there were always two questions to consider: whether there was a duty, and whether it had been breached. In some jurisdictions, where a company was near insolvency, the directors were required to make enquiry about whether the company was solvent before undertaking significant transactions (such as transactions risking half of its assets, significant transfers of assets or distributions to shareholders). Directors could also be required to justify the transactions concerned and that they had taken the possibility of insolvency into account.

86. The importance of avoiding the notion of strict liability was underscored; insolvency representatives taking action would need to show the duty, a breach and

that the breach in fact caused harm. Any other approach, it was said, would indeed compromise the objective of promoting good practice in insolvency without compromising entrepreneurship.

87. In this regard, it was agreed that the existence of any liability would be entirely fact-specific, and a mechanism to examine the facts would be critical. From this perspective, drafting lists of bad management practice would be endless and counterproductive, and would effectively lead to strict liability in some situations. In addition, such an approach would not take account of changing circumstances, which might unjustifiably change the characterization of a decision. In that light, it was said that it would be impossible to provide a universal definition of such a duty. A more constructive approach, it was considered, would be to provide guidance on how to discharge the duty itself, addressing the steps that could or should be taken. Appropriate action might include continuing to trade in an attempt to turn the company around or putting it into liquidation, or many steps in between. Appropriate steps when insolvency was likely could include providing notifications to interested parties (though not going beyond the obligations in a formal insolvency proceeding), diligence in running the company, and taking steps for the benefit of the estate.

88. Another view was that it would be possible to craft an abstract statement of duties based on utmost diligence, putting emphasis on directors' being able to show that they had taken all reasonable steps to put the company on a good or improved footing. Nonetheless, the standard should be set at a reasonable level, since otherwise, directors might simply resign, with negative consequences for a subsequent reorganization or insolvency proceeding.

89. A further consideration was that the duties should relate to the identities of the group to which they were owed: in particular, to ensure that duties did not remain restricted to the company as such (rather than the estate).

90. In the light of these considerations, the Working Group agreed to base its future deliberations on identifying the steps that would need to be taken to discharge the duty identified in item (i).

91. As regards the examples of breach of duty (paragraph 3 (d) (ii)) and misconduct involving company money or property (paragraph 3 (d) (iii)), it was recalled that the Legislative Guide already included provisions on preferences and transactions that could be avoided; they also raised general duties of directors outside the insolvency context, and therefore that the emphasis of future work should be on item wrongful trading (paragraph 3 (d) (i)), and it was noted that the class of persons that might be protected might need to be restricted.

(e) Identifying the remedies available for that behaviour or breach of duty

92. The three questions outlined in paragraph 63 of A/CN.9/WG.V/WP.96 were considered.

93. It was observed that the primary aim of enforcement action was to restore the estate to the position in which it would have been absent the misconduct that gave rise to the enforcement action, and that the nature of the action to be taken would therefore be based on that aim. Such action might be termed wrongful or insolvent trading, but the terminology would be an issue for future consideration. Without

effective remedies being available, it was added, the debate would be purely academic, and the policy aims of current work remain unfulfilled. It was also observed that a regime that contemplated the enforcement of duties had a deterrent effect and could promote good practice in company management in the vicinity of insolvency; nonetheless, provisions should not be crafted in such a manner that they would encourage insolvency proceedings, because of the risks of personal liability, to be commenced in premature fashion.

94. It was observed that the number of actions for wrongful or insolvent trading were fewer than might be expected given the number of insolvencies, and that, as a result, while the cause of action might be considered to be the appropriate one, guidance should seek to address any obstacles to effective action. In addition to the issue of securing funding to pursue actions, it was noted that many cases might settle, or the directors might not have sufficient assets to make an action cost-effective.

95. An additional potential remedy, it was said, was the possibility of subordination of claims on the insolvent estate by directors that had engaged in misconduct. Support was expressed for the proposition that subordination might provide an effective remedy, and it was agreed that further study of the topic was required, with a view to allowing the Working Group to consider it among available remedies at a future session.

96. The Working Group was urged to take care in considering possible remedies to avoid exceeding its mandate, in that they raised questions to be decided in each State both as regards the nature of claims and the proper person to pursue them, together with related issues such as burden and standard of proof.

97. As regards the person that had the right to take enforcement action, it was stated that the persons to which a relevant duty was owed, and that had sustained loss, should have that right. There was agreement that the right would normally accrue to the insolvency representative, as the representative of the insolvent estate, to be exercised with regard to the collective interests of creditors. As regards other classes of persons, it was noted that a wide variety also had the right to pursue directors in various legal systems, and that there was no common approach. They included creditors as individuals, creditors as a collective body, classes of creditors or a creditors' committee, companies (i.e. legal persons), the state prosecutor, and a court-appointed trustee or examiner (where such a person would be needed because of conflicts of interest arising in cases in which directors continued to manage the company during the insolvency).

98. As regards creditors, it was noted that rights that might accrue under other bodies of law (civil law, company law or tort law) were not to be considered here, though it was observed that such other bodies of law might inform the manner in which provision for enforcement action would be made, and it was agreed that the insolvency provisions should not in any way negate those rights. To the extent that a duty to creditors existed separate to that owed to the estate, the creditors concerned should be able to enforce it for reasons of consistency; if a decision were made to remove that right, the reasons for adopting such a policy should be set out clearly. An alternative approach, it was said, drawing on provisions in Recommendation 87 of the Legislative Guide on avoidance of transactions, would be to allow creditors to request the insolvency representative to take action; if he did

not, creditors might be able to take action themselves; in certain circumstances they might have a cause of action against the insolvency representative.

99. It was also noted that a creditor would generally not have the evidence required to pursue a claim and the extent of the creditor's damage would be difficult to establish. Support was expressed for the proposition that the proceeds of any successful action should accrue to the estate as a whole, though a creditor that had taken action should be able to recover its costs and fees. Nonetheless, it was observed that in certain jurisdictions the proceeds of actions did not necessarily flow to all creditors (for example where there were relevant security interests). It was noted that these issues would be further explored at a future date.

100. It was also noted that a potential claim was an asset of the insolvent estate, and an insolvency representative should have the flexibility and obligation to deal with it as with any other asset: the appropriate action might include a disposal of that asset to a creditor — in other words, the right of action could be assigned (for value) to that creditor. This approach, it was added, could also assist in addressing one observed obstacle to enforcement action: a lack of funds to pursue the claim. As regards the latter question, it was also noted that creditors might be willing to fund the insolvency representative in pursuing a claim because of the potential benefits.

101. As regards other potential persons that might have the right to take enforcement action, caution was urged to avoid encroaching on criminal procedures (as might be the case should a state prosecutor become involved). Nonetheless, it was noted, there might be some overlap between civil and criminal remedies where actions seeking pecuniary compensation were pursued, and it might be appropriate to refer to the impact of existing criminal proceedings on action in the insolvency.

102. The experience in some jurisdictions on enforcement actions was shared, and the benefits of streamlined procedures avoiding the costs and length of some types of litigation were noted.

103. As regards the timing of enforcement action, it was noted that prior to the commencement of insolvency, creditors might have remedies against directors, but that those remedies would arise under other bodies of law. Accordingly, it was agreed that these remedies should not be the subject of further discussion by the Working Group in connection with the topic.

104. A separate remedy outlined in A/CN.9/WG.V/WP.96 was the possibility of disqualification of directors. It was stated that this was intended to be an administrative and not a criminal sanction, though the risks of overlap were again emphasized. The aim of the remedy was not to punish the director concerned, but in addition to the question of deterrence, to protect the general public from the activities of an individual that had proved him- or herself unsuitable to run a limited liability company. It was considered that this remedy was ancillary to the main question of restoring the insolvent estate; while it was stated to be a mechanism to be considered, views differed as to the extent to which it should be addressed by the Working Group.

105. Another view was that disqualification actions were outmoded, reflecting a punitive approach that was no longer considered constructive, and that such actions inevitably involved an overlap with criminal matters. It was also noted that effectiveness of disqualification might be open to question if a disqualified director

could simply carry on as a de facto or shadow director, or if measures were not in place to ensure that disqualification could have a cross-border effect. On the other hand, it was suggested that the possibility of disqualification was an effective deterrent. It was agreed to revert to these issues at a future session.

106. The Working Group considered the possible defences that directors might raise in the context of an enforcement action. It was noted that the prospects of an informal reorganization might be jeopardized if the risks of liability were too great. It was observed that possible defences could include that there were reasonable grounds to expect the company might be solvent, and particular steps to be taken might include the drawing up of accounts revealing a fair record of the company's finances, taking advice from a suitable professional, and that the proposed course of action is in the creditors' interests and that the directors were pursuing a restructuring. It was noted that there was a link between the manner in which the duty was phrased and possible defences; these items outlined above could be treated either as possible defences or as a manner of discharging the primary duty.

107. The practical difficulties that protracted litigation on these issues involved were recalled, including those arising from establishing the facts and the steps necessary to discharge the duty. From this perspective, it was suggested that the duty could be crafted to describe actions that should put the director on notice of the possible risks (such as the transfer of a proportion of assets, transactions exceeding a threshold, engaging in a risky activity putting at risk a certain proportion of the assets), to supplement the principle itself. In practical terms, it was added, the director would have to be able to demonstrate his or her consideration of the effect of proposed actions on the company's solvency and, if insolvency were a possibility, what steps he or she had taken to protect the interests of creditors and so forth.

108. It was agreed that striking the right balance between promoting appropriate behaviour and avoiding premature insolvency would be a key element of the guidance to be drafted, and that the issues set out above would be taken up at a future session.

(f) Cross-border issues

109. A series of issues relating to cross-border issues was raised. First, it was noted that the Model Law was silent on jurisdiction, which therefore remained a matter of private international law. The Working Group was encouraged to consider that, in actions related to insolvency, specialized courts would be the appropriate forum, and so guidance to such end would be useful. Secondly, as regards applicable law, a variety of solutions among legal systems were observed to operate in practice (as regards both proceedings and questions of liability and damages), it was noted. Thirdly, the Model Law was noted to grant access by foreign representatives to other jurisdictions in limited circumstances, but these did not include liability actions. Finally, the question of whether defences in one jurisdiction would apply in proceedings in another was raised. The Working Group took note of the comments made, and agreed to revert to the issues at a future session.

VI. Judicial materials on the UNCITRAL Model Law on Cross-Border Insolvency

110. The Working Group discussed the judicial materials on the Model Law on the basis of document A/CN.9/WG.V/WP.97 and its addenda.

111. As background explanation to the judicial materials, the Working Group noted that participants in the judicial colloquium that had been held by UNCITRAL in cooperation with INSOL and the World Bank had indicated a desire for information and guidance for judges on cross-border-related issues and in particular on the Model Law. In that light, the Commission had mandated the Secretariat to develop such text in the same flexible manner as was achieved with respect to the *UNCITRAL Practice Guide on Cross-Border Insolvency Cooperation*[3] (the "Practice Guide") involving insolvency practitioners and professionals and with a view to consideration at an appropriate stage by Working Group V and finalization and adoption by the Commission, possibly in 2011.[4]

112. It was explained that the judicial materials were of a purely descriptive nature with the aim to provide assistance to judges on the Model Law pursuant to the Commission's mandate and thereby enhancing predictability and consistency of case law. It was further explained that references to cases were included in the judicial materials to illustrate different views taken in the interpretation of the Model Law. To enhance the purpose of the judicial materials, it was said that it would be beneficial if those materials could be updated on an ongoing basis in consultation with judges and practitioners. To that end, it was suggested that publication in electronic format might be particularly appropriate.

113. The Working Group generally agreed that the judicial materials would constitute a very useful document that would assist judges in Model Law countries and also in those countries that had not enacted the Model Law, where the document would greatly facilitate the adoption of the Model Law.

114. Some points were raised for possible addition or clarification in the judicial materials, as follows: (1) whether a foreign representative could represent the debtor in a proceeding other than insolvency proceeding (civil litigation) without prior recognition; (2) the meaning of the term "participate in existing proceeding" in paragraph 29 (b) in the light of its footnote reference to article 12 of document A/CN.9/WG.V/WP.97; (3) the meaning of the term "intervene" in paragraph 29 (d) of document A/CN.9/WG.V/WP.97; (4) the need to address the enterprise group context in more detail; (5) the need to acknowledge that not all domestic legislation would require an "establishment" pursuant to article 2 (f) for a non-main proceeding; and (6) whether a receiving court could reconsider the determination of the initial court on the question of COMI.

115. It was suggested that the title of the judicial materials should be "Judicial Guide", which would be in line with other UNCITRAL texts, such as the Legislative Guide and the Practice Guide. In response, it was said that the word "guide" had not been chosen, as it would insufficiently capture its descriptive nature. It was

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[3] United Nations publication, Sales No. E.10.V.6.

[4] *Official Records of the General Assembly, Sixty-fifth Session, Supplement No. 17* (A/65/17), para. 261.

suggested that the title should avoid conveying the impression that the judicial materials were prescriptive in nature.

116. The Working Group agreed that the judicial materials should be further developed in light of the comments made at the current session, with a view to its possible finalization at the next session. The Working Group invited comments from States on their experience with the Model Law to be submitted to the Secretariat for possible consideration in the preparation of a revised draft.

117. The Working Group heard information by the World Bank on the Insolvency and Creditor Rights Standard (the "ICR Standard") that was part of the Financial Stability Board's Standards and Codes Initiative and was used by the World Bank in the ICR Reports on the Observance of Standards and Codes (the "ICR ROSC"). It was recalled that the ICR Standard already included the recommendations contained in the Legislative Guide and the World Bank Principles for Effective Insolvency and Creditor Rights Systems. The ICR Standard had been developed in coordination with the UNCITRAL secretariat. The Working Group was further informed that the ICR Standard was currently in the process of being updated to take into account part three of the Legislative Guide. The Working Group took note of that development with appreciation and requested the Secretariat to continue participating in the process, in close cooperation with the World Bank.