United Nations A/CN.9/WG.V/WP.179

General Assembly

Distr.: Limited
7 February 2022

Original: English

United Nations Commission on International Trade Law
Working Group V (Insolvency Law)
Sixtieth session
New York, 18–21 April 2022

Applicable law in insolvency proceedings

Note by the Secretariat

Contents

V.22-00525 (E)

I. Introduction

1. The background information about the project on applicable law in insolvency proceedings referred to the Working Group by the Commission at its fifty-fourth session, in 2021,[1] may be found in the provisional agenda of the sixtieth session of the Working Group (A/CN.9/WG.V/WP.177, paras. 12–14). As noted there, the Working Group commenced work on the project at its fifty-ninth session (Vienna, 13–18 December 2021). This note was prepared by the secretariat further to the Working Group's expectation that materials reflecting deliberations of the Working Group on the topic at the fifty-ninth session would be presented for consideration by the Working Group at its next session. In the light of unresolved issues as regards the form of a future instrument on the topic and its content, the Working Group left flexibility to the secretariat to decide on how those materials should be presented to the Working Group.[2]

2. This note outlines issues raised in the Working Group in relation to the law applicable in insolvency proceedings with respect to a single debtor. The understanding is that deliberations at the Working Group's sixtieth session will focus on issues arising from recommendations 31 to 34 of the UNCITRAL Legislative Guide on Insolvency Law (the "Guide"). Consequently, this note does not cover issues arising from the law applicable to validity and effectiveness of rights and claims before the commencement of insolvency proceedings, addressed in recommendation 30 of the Guide, to be read together with recommendations 3 and 4 of the Guide, and issues arising from the law applicable in concurrent insolvency proceedings, including in the enterprise group insolvency context. Neither it covers aspects of private international law of general application, such as limits to application of foreign law[3] and rules for localization of assets.

3. The note cross refers to UNCITRAL insolvency texts, the report of the fifty-ninth session of the Working Group (A/CN.9/1088) and a note by the Secretariat that was before the Working Group at its fifty-ninth session (A/CN.9/WG.V/WP.176). When the context so required, the secretariat elaborated on some points raised at the fifty-ninth session of the Working Group in relation to recommendations 31–34 of the Guide. Other UNCITRAL texts as well as other relevant international and regional texts were consulted in that respect, in particular UNCITRAL texts on secured transactions, Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (recast) (the "EIR recast")[4] and the Global Rules on Conflict-of-Laws Matters in International Insolvency Cases of the American Law Institute and the International Insolvency Institute, including comments and the Reporters' Notes (the "Global Rules").

4. Pending the Working Group's decision about the form of a future instrument on the topic, the secretariat uses a generic reference to the "legislative provisions" throughout this note. The Working Group may wish to consider issues outlined in this note, including whether they should be treated in the legislative provisions or any future accompanying commentary thereto and elements for inclusion in either.

---

[1] *Official Records of the General Assembly, Seventy-sixth Session, Supplement No. 17* (A/76/17), paras. 215–217.

[2] A/CN.9/1088, paras. 94 and 95.

[3] See in that context, for example, A/CN.9/WG.V/WP.176, para. 18 referring to the universally accepted choice of law rule that courts apply their own procedural law.

[4] Binding and directly applicable in European Union (EU) member States. Its scope is limited to proceedings in respect of a debtor whose centre of main interests is located in the EU (see recital 25). It replaced and superseded Council Regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings, which in turn was based on the European Union Convention on Insolvency Proceedings (done at Brussels on 23 November 1995; did not enter into force).

II. Outline of issues for further consideration by the Working Group

A. Purpose and objectives

5. The Working Group may wish to consider that, consistent with the mandate of UNCITRAL, the goal of the project should be to achieve harmonization of the existing divergent legislative approaches to the law applicable in insolvency proceedings. This would respond to a call for "much needed stability in the otherwise volatile and uncertain process of evaluating the possible consequences of insolvency for international commercial relationships".[5] The existence of divergent, fragmented and incomplete legislative approaches to the law applicable in insolvency proceedings, which may lead to inconsistency and lack of predictability in cross-border insolvency cases, underlined the Commission's decision to take up the project.[6]

6. The Working Group may wish to consider whether, consistent with that goal, the purpose of the legislative provisions would be to offer to States simplified and updated rules on the law applicable in insolvency proceedings, in response to the needs that have emerged in insolvency practice since 2004 when the relevant part of the Guide was adopted. The legislative provisions would: (a) reinforce the application of the law of the State of the opening of the insolvency proceeding (*lex fori concursus*) to all aspects of insolvency proceedings, including effects of insolvency proceedings on persons, rights, claims and proceedings, subject to limited and clearly specified exceptions; and (b) clarify the meaning and scope of that law and exceptions thereto.

7. The Working Group may wish to confirm[7] whether the legislative provisions should promote inter alia the objectives of: (a) enhancing certainty and predictability (i.e. parties affected by insolvency proceedings will be better able to anticipate the effects and outcome of the insolvency proceedings on their rights and claims); (b) improving efficiency and effectiveness of insolvency proceedings having cross-border effects (e.g. through reduction of complexities and costs of insolvency proceedings and better coordination of liquidation and reorganization proceedings across borders); and (c) preventing abusive forum shopping and other improprieties that jeopardize legitimate expectations of creditors and other parties in interest.[8] The Working Group may also wish to consider that, in addressing each of those objectives, the legislative provisions would need to achieve an appropriate balance between competing considerations.

B. Scope of application of the legislative provisions

8. The scope of application of the legislative provisions is linked to the scope of "insolvency proceedings" intended to be covered, which was discussed at the fifty-ninth session of the Working Group.[9] UNCITRAL insolvency texts acknowledge that different jurisdictions may have different notions of what falls within the term "insolvency proceedings".[10] They set out a cumulative list of requisites that a proceeding must meet in order to be considered an "insolvency proceeding" for the purposes of UNCITRAL insolvency texts: (a) collective proceeding (judicial or

[5] See the Statement of the Reporters of the Global Rules.

[6] *Official Records of the General Assembly, Seventy-sixth Session, Supplement No. 17* (A/76/17), paras. 216 and 217.

[7] A/CN.9/1088, para. 57.

[8] For the explanation of the term "parties in interest", see the Glossary of the Guide, term (dd).

[9] A/CN.9/1088, paras. 62, 64, 65 (f) and 68.

[10] See e.g. the Glossary of the Guide, terms (s) and (u), to be read together and also with the explanation provided in part one, para. 2; the Guide to Enactment of the UNCITRAL Model Law on Recognition and Enforcement of Insolvency-related Judgments (MLIJ) (GE), para. 22; and the Guide to Enactment and Interpretation of the UNCITRAL Model Law on Cross-Border Insolvency (MLCBI) (GEI), para. 48.

administrative); (b) pursuant to a law relating to insolvency; (c) under control or supervision by a court; (d) with respect to a debtor (natural or legal person) that is in severe financial distress or insolvent; and (e) with the goal of liquidating or reorganizing that debtor as a commercial entity.[11] A judicial or administrative proceeding to wind up a solvent entity and other proceedings not meeting those requisites are not insolvency proceedings under UNCITRAL insolvency texts.[12] The Working Group may wish to consider whether the same considerations would apply to defining "insolvency proceedings" in the legislative provisions. In that context, the Working Group may wish to recall that, for example, the newly added recommendation 294 allows eligible debtors to apply for commencement of a simplified insolvency proceeding at an early stage of financial distress without the need to prove insolvency.

9. At the fifty-ninth session of the Working Group, it was considered that reference to "insolvency proceedings" in the chapeau of recommendation 31 should encompass "interim proceedings" and "any other pre-insolvency proceedings with sufficient connection to insolvency".[13] Relevant thereto was a suggestion to add reference to "restructuring" or "restructuring law" as a separate item in the list of items in recommendation 31, or alternatively explain in a commentary that the terms "insolvency proceedings" and "insolvency law" found in the chapeau of recommendation 31 captured those aspects.[14] (See paragraphs 13–15 below for discussion of the term "insolvency law").

10. The Working Group may wish to note that, although no reference to "interim proceedings" is found in the term "insolvency proceedings" in the Guide (Glossary, term (u)), it is included in the definitions of "insolvency proceedings" and "foreign proceedings" in UNCITRAL insolvency model laws. The relevant commentary explains that "interim proceedings" should not be distinguished from other insolvency proceedings merely because they are labelled interim and of an interim nature.[15] If interim proceedings meet the cumulative list of requisites set out in paragraph 8 above, they will be considered "insolvency proceedings" under UNCITRAL insolvency texts.

11. The same test should apply to "restructuring" or "any other pre-insolvency proceedings with sufficient connection to insolvency". Those references may benefit from further clarification. For example, they may refer to voluntary restructuring negotiations mentioned in part one of the Guide among mechanisms for resolving a debtor's financial difficulties and in part two of the Guide in the context of expedited reorganization proceedings (see recs. 160–168). The Guide explains that voluntary restructuring negotiations typically involve restructuring of the debt due to lenders and other institutional creditors and major non-institutional creditors where their participation is crucial to the restructuring, but not involving all categories of creditor. The suggested references to "restructuring" or "any other pre-insolvency proceedings with sufficient connection to insolvency" may also encompass informal debt restructuring negotiations addressed in the newly added recommendations 374–376 among mechanisms for avoiding insolvencies of micro- and small enterprises. The Guide notes that they are also usually held with a limited number of creditors. While acknowledging that success of different types of out-of-court debt restructuring negotiations often depends upon the existence of an effective and efficient insolvency law, the Guide emphasizes that they are usually held outside the insolvency law. Agreements or arrangements resulting from those negotiations are usually governed by contract law, company or commercial law or civil procedure law or in some cases banking regulations.

[11] See GE, para. 49; and GEI, paras. 65–78.
[12] See e.g. GE, para. 22; and GEI, para. 48.
[13] A/CN.9/1088, para. 68.
[14] A/CN.9/1088, para. 65 (f).
[15] GEI, para. 79.

12. “Insolvency proceedings” under UNCITRAL insolvency texts encompass both reorganization and liquidation. At its fifty-ninth session, the Working Group discussed whether preparation of separate sets of applicable law rules for liquidation and reorganization would be justified in the light of distinct issues that these two types of insolvency proceeding raise, in particular as regards the need to use encumbered assets and hence involve secured creditors. It was considered sufficient to elaborate on those issues in a commentary of a future text.[16]

C. Default rule for the law applicable in insolvency proceedings: *lex fori concursus*

1. The meaning of lex fori concursus

13. The Guide explains the term *lex fori concursus* as the law of the State in which the insolvency proceedings are commenced (Glossary, term (x)). The opening phrase in recommendation 31 of the Guide narrows down *lex fori concursus* to “the insolvency law of the State in which insolvency proceedings are commenced (*lex fori concursus*)”. At its fifty-ninth session, the Working Group agreed to interpret the term “insolvency law” found in the chapeau of recommendation 31 broadly as encompassing other laws with sufficient connection to insolvency. It was considered sufficient to elaborate on such intended broad interpretation in any amended commentary to that provision that might be prepared in due course. A specific reference in that context was made to company law provisions addressing directors’ obligations and liabilities and the approach taken in the UNCITRAL Model Law on Recognition and Enforcement of Insolvency-Related Judgments (MLIJ).[17]

14. Two aspects may be relevant in that respect: (a) the phrase “arises as a consequence of or is materially associated with insolvency proceedings” included in the definition of “insolvency-related judgment” (article 2 (d)(i)(a) of MLIJ); and (b) the phrase “a law relating to insolvency” found in the definition of “insolvency proceedings” (article 2(a) of MLIJ). The drafting history of the definition of “insolvency-related judgment” in MLIJ[18] indicates that the phrase in (a) was included in preference to the phrase “derives directly from and is closely linked to the insolvency proceedings” as a compromise for specific purposes of MLIJ.[19] In comparison, the phrase “a law relating to insolvency” is used also in other UNCITRAL insolvency texts.[20] The choice of that formulation is explained in UNCITRAL insolvency model laws by the fact that liquidation and reorganization might be conducted under law that is not labelled as insolvency law (e.g. company law), but which nevertheless deals with or addresses insolvency or severe financial distress. The purpose was to find a description that was sufficiently broad to encompass a range of insolvency rules irrespective of the type of statute or law in which they might be contained and irrespective of whether the law that contained the rules related exclusively to insolvency.[21] The choice of that formulation in the Guide in the context of director’s obligations in the period approaching insolvency (including in enterprise groups) is explained by the fact that director obligations and liabilities may be specified in different laws, including company and insolvency laws, and a potential overlap and conflicts between those laws in the period approaching insolvency of the debtor need to be reconciled.[22]

15. The Working Group may wish to consider whether, in the light of the above considerations, an inconsistency in the explanation of the term *lex fori concursus* in

[16] A/CN.9/1088, para. 89.
[17] A/CN.9/1088, paras. 63 and 68.
[18] See e.g. A/CN.9/903, paras. 68–73 and 77; and A/CN.9/931, para. 17 (b).
[19] See GE, para. 21.
[20] See e.g. article 2(a) MLCBI; article 2(h) MLEGI; and the Guide (recommendations and footnote 6 in part four; and recommendation 372 in part five).
[21] See e.g. GEI, para. 73.
[22] See part four, section one, Background, para. 11.

the Glossary and recommendation 31 should be reconciled in the legislative provisions. The Working Group may also wish to clarify elements for inclusion in a commentary, noting issues raised in paragraphs 14-16 of document A/CN.9/WG.V/WP.176, in particular whether rules of private international law of the State of commencement of an insolvency proceeding are intended to be captured.

2. Reinforcing the application of *lex fori concursus* and clarifying its scope

16. The Working Group may wish to consider that, consistent with recommendation 31 of the Guide, *lex fori concursus* would apply to all aspects of insolvency proceedings and their effects unless explicitly stated otherwise. In that context, the Working Group may wish to recall that, at its fifty-ninth session, views were expressed that the observed convergence of substantive insolvency rules should make the application of *lex fori concursus* to insolvency proceedings less problematic.[23]

17. At its fifty-ninth session, the Working Group considered the following suggestions for clarifying the scope of *lex fori concursus*: (a) to expand the illustrative list of items found in recommendation 31; (b) to elaborate on the content of some items already listed there, by this removing any ambiguity that *lex fori concursus* would apply to the elaborated aspects; (c) to subject the application of *lex fori concursus* to certain conditions as regards some items on the list (avoidance and set-off (items (g) and (i)); (d) to replace *lex fori concursus* with other law, in particular for rights *in rem* (this was discussed in relation to the treatment of secured creditors (item (j) on the list)); and (e) to clarify interaction of *lex fori concursus* with the law of the recognizing State. Those suggestions are set out below in conjunction with the relevant items in recommendation 31 (cross references in parentheses are to the recommendations of the Guide that address the listed items).

18. No comments were raised with respect to other listed items, which are: item (a) Identification of the debtors that may be subject to insolvency proceedings (see recs. 8–13 and 292 of the Guide); item (b) Determination of when insolvency proceedings can be commenced and the type of proceeding that can be commenced, the party that can apply for commencement and whether the commencement criteria should differ depending upon the party applying for commencement (see recs. 14–29, 293–297 and 304 of the Guide); item (e) Use or disposal of assets (see recs. 52–62 of the Guide); item (f) Proposal, approval, confirmation and implementation of a plan of reorganization (see recs. 139–159 and 338–353 of the Guide); item (m) Functions of the creditors and creditor committee (see recs. 126–136 of the Guide); item (p) Costs and expenses relating to the insolvency proceedings (see recs. 26, 125 and 280 of the Guide); item (q) Distribution of proceeds (see recs. 191–193 and 334 of the Guide); item (r) Conclusion of the proceedings (see recs. 197–198 and 362 of the Guide); and item (s) Discharge (see recs. 194–196 and 354–361 of the Guide). It may thus be considered uncontroversial to list those items in the legislative provisions as examples of aspects of insolvency proceedings covered by *lex fori concursus*.

Item (c). Constitution and scope of the insolvency estate (see recs. 35–38 and 313–315 of the Guide)

19. At the fifty-ninth session of the Working Group, it was considered useful to reinforce the application of *lex fori concursus* to the treatment of digital assets, intellectual property rights and licences in insolvency proceedings as part of the debtor's insolvency estate.[24] Specifics of those assets (in particular, difficulties with their localization and establishing jurisdiction) were recalled in that context. The Working Group may wish to note that, while the Guide does not contain any reference to "digital assets" or "licences", it explicitly refers to intellectual property rights when describing "intangible assets" constituting the insolvency estate.[25] The Working

[23] A/CN.9/1088, para. 86.
[24] A/CN.9/1088, para. 91.
[25] See recommendations 35–38 and accompanying commentary.

Group may wish to consider that digital assets and licences would fall under the same category and should receive the same treatment.

Item (d). Protection and preservation of the insolvency estate (see recs. 39–51 and 317 and 318 of the Guide)

20. The item encompasses provisional measures, stay of proceedings, exceptions from stay, protection from diminution of the value of encumbered assets and relief from provisional measures and stay. "Stay of proceedings" would apply to judicial, administrative, arbitral proceedings and other individual actions concerning the debtor's assets, rights, obligations or liabilities, including actions to make security interests effective against third parties or to enforce a security interest. It would also apply to execution against the assets of the insolvency estate, the termination of a contract with the debtor (including automatic termination and acceleration (ipso facto) clauses (see item (h) below)) and the transfer, encumbrance or other disposition of any assets or rights of the insolvency estate.[26]

21. At its fifty-ninth session, the Working Group noted practical difficulties with enforcing stay of proceedings across borders, in particular as regards secured creditors' enforcement actions with respect to the collateral located neither in the State of the opening of the insolvency proceeding nor in the recognizing State.[27] Such practical difficulties could be addressed by stay and other relief available under UNCITRAL insolvency model laws only to some extent since the scope, duration, modification, suspension or termination of stay and other relief in the recognizing State are determined by provisions of the laws of that State, not *lex fori concursus*. The scope of stay and other relief may thus be different in the State of the opening of the insolvency proceeding and in the recognizing State. Differences often arise in particular as regards exceptions for secured claims, payments by the debtor in the ordinary course of business, set-off and execution of rights *in rem*. At its fifty-ninth session, the Working Group was invited to consider those issues in due course.[28]

22. UNCITRAL insolvency texts acknowledge those practical difficulties, in particular in the context of international arbitration in the light of its relative independence from the legal system of the State where the arbitral proceeding takes place.[29] At the fifty-ninth session of the Working Group, support was expressed for elaborating on the effects of *lex fori concursus* on arbitral proceedings building on the existing commentary to article 20 of the UNCITRAL Model Law on Cross-Border Insolvency (MLCBI). That commentary notes that article 20 (1)(a) of MLCBI, by not distinguishing between various kinds of individual action, also covers actions before an arbitral tribunal. Thus, article 20 establishes a mandatory limitation to the effectiveness of an arbitration agreement. This limitation is added to other possible limitations restricting the freedom of the parties to agree to arbitration that may exist under national law (e.g. limits as to arbitrability or as to the capacity to conclude an arbitration agreement).

23. In discussing those issues further, the Working Group may wish to consider whether the effects of *lex fori concursus* on arbitral proceedings extend beyond the application of stay of proceeding and whether similar effects would extend also to pending lawsuits. In that context, the Working Group may wish to note that one surveyed text provides that effects of insolvency proceedings on a pending lawsuit or pending arbitral proceedings concerning an asset or a right which forms part of a debtor's insolvency estate shall be governed solely by the law of the State in which that lawsuit is pending or in which the arbitral tribunal has its seat.[30] It should be

[26] See the Glossary of the Guide, term (rr), and recommendation 46 and its accompanying footnotes.

[27] A/CN.9/1088, para. 86.

[28] Ibid.

[29] See e.g. footnote 20 to recommendation 46 of the Guide, cross-referring to article 20 of MLCBI, and GEI, para. 180.

[30] See article 18 of the EIR recast.

noted in that respect that: (a) under recommendations 47 (the last sentence) and 318(a) of the Guide as well as article 20(3) of MLCBI, individual actions or proceedings to the extent necessary to preserve a claim against the debtor are excluded from the application of the stay; and (b) the interests of the parties may be a reason for allowing an arbitral proceeding to continue, a possibility that is envisaged in provisions allowing relief from the stay (article 20(2) of MLCBI and its accompanying commentary and recs. 49 and 317 of the Guide).

Item (g). Avoidance of certain transactions that could be prejudicial to certain parties (see recs. 87–99 and 316 of the Guide)

24. At its fifty-ninth session, the Working Group heard different views on desirability of protecting a transaction from avoidance under *lex fori concursus* if the transaction is subject to the law other than *lex fori concursus* and that other law does not allow any means of challenging that transaction in the relevant case.[31] The Working Group may wish to consider that aspect further, recalling issues raised in paragraph 25 of document A/CN.9/WG.V/WP.176, paragraphs 26 and 27 of the Colloquium report (A/CN.9/1060) and a safeguard found in one surveyed text that aim at preventing the abusive choice of law where the protection against avoidance under *lex fori concursus* is available.[32]

25. A deviation from the approach to avoidance taken when the draft Guide was prepared would be expected to be justified, for example with reference to the newly emerged needs or practices. The Working Group may wish to recall in that context a view expressed at the fifty-ninth session of the Working Group that, although paragraphs 89 and 90 of the commentary to recommendations 30–34 of the Guide note different approaches to determining the law governing the avoidance of transactions and policies underlying those approaches, they did not explain clearly why exceptions to *lex fori concursus* did not encompass avoidance.[33]

Item (h). Treatment of contracts (see recs. 69–86 of the Guide)

26. At the fifty-ninth session of the Working Group, support was expressed for adding reference to ipso facto clauses in item (h) or separately.[34] The Guide addresses ipso facto clauses in recommendations 70 and 71 referring to them as automatic termination and acceleration clauses and describing them as any contract clause that automatically terminates or accelerates a contract upon the occurrence of any of the following events: (a) an application for commencement, or commencement, of insolvency proceedings; and (b) the appointment of an insolvency representative. As explained in the context of item (d) above, stay of proceedings would apply to such clauses under the Guide. The Guide also provides for unenforceability of those clauses as against the insolvency representative and the debtor subject to some exceptions (e.g. financial contracts, contracts for irreplaceable and personal services) or subject to special rules (labour contracts).

27. In addition, as relevant to this item, reference was made to article 11 of the EIR recast that provide for a special treatment of contracts relating to immoveable property, in particular that the effects of insolvency proceedings on a contract conferring the right to acquire or make use of immoveable property shall be governed

[31] A/CN.9/1088, para. 83 and its accompanying footnote with reference to article 16 of the EIR recast.

[32] See Global Rule 23 (to be read with Global Rule 22 that is similar to article 16 of the EIR recast). The safeguard provides that an exemption from the effect of the avoidance rule of the law of the State of the opening of insolvency proceedings does not apply if proof is provided that the State to whose law the transaction is subject has no substantial relationship to the parties or the transaction, and there is no other reasonable basis for the selection of the law of that State as the law to govern the transaction in question. It is for the party who claims that such conditions are met, in relation to a particular transaction, to prove that those conditions are in fact met in the relevant case.

[33] A/CN.9/1088, para. 78.

[34] A/CN.9/1088, para. 65 (a).

solely by the law of the State within the territory of which the immoveable property is situated.[35]

Item (i). [Treatment of] Set-off (see rec. 100 of the Guide)

28. At the fifty-ninth session of the Working Group, support was expressed for opening item (i) with the words "treatment of" in order to better convey that the item focused on the availability and conditions of set-off under insolvency law, rather than aspects of set-off under other law (e.g. contract law, property law).[36]

29. In addition, the Working Group heard different views on the law that should prevail as regards the right of creditors to demand the set-off of their claims against the claims of a debtor.[37] The Working Group may wish to consider that aspect further, recalling issues raised in paragraph 24 of document A/CN.9/WG.V/WP.176 and a safeguard found in one surveyed text.[38] In addition, the Working Group may wish to note that recommendation 100 of the Guide provides that the insolvency law should protect a general right of set-off existing under law other than the insolvency law that arose prior to the commencement of insolvency proceedings, subject to the application of avoidance provisions.

Item (j). Treatment of secured creditors[39]

30. The item encompasses provisions of the Guide on: (a) application of stay of proceedings on secured creditors (see e.g. recs. 46 (b) and 49); (b) protection of secured creditors from diminution of the value of encumbered assets (see e.g. recs. 50–67); (c) possibility of avoidance of security interests (rec. 88); (d) whether secured creditors are required to submit claims in insolvency proceedings (rec. 172); and (e) priority of secured claims, addressing also claims that may be superior in priority to secured claims (rec. 188). At the fifty-ninth session of the Working Group, this item was discussed in a broader context of the treatment of rights *in rem* in insolvency proceedings.[40]

31. UNCITRAL texts do not define rights *in rem*. In some instances, they identify certain rights as property rights (*in rem*) effective against third parties or as a right in an asset (right *in rem*) as opposed to a personal right (right *ad personam*).[41] The commentary to article 32 of MLCBI notes that the words "secured claims" are used to refer generally to claims guaranteed by particular assets, while the words "rights *in rem*" are intended to indicate rights relating to a particular property that are enforceable also against third parties. The commentary acknowledges that a given right may fall within the ambit of both expressions, depending on the classification and terminology of the applicable law, and invites enacting States to use another term or terms for expressing those concepts.[42]

---

[35] A/CN.9/1088, para. 83 and its accompanying footnote with reference to article 11 of the EIR recast.

[36] A/CN.9/1088, para. 65 (b).

[37] A/CN.9/1088, para. 83 and its accompanying footnote with reference to article 9 of the EIR recast.

[38] See Global Rule 18 (to be read with Global Rule 17 that is similar to article 9 of the EIR recast). The safeguard provides that the rule giving priority to the law applicable to the insolvent debtor's claim would not apply if the law of the State chosen by the parties has no substantial relationship to the parties or the transaction, and there is no other reasonable basis for the parties' choice and in the absence of express choice made by the parties, the law applicable to the insolvent debtor's claim would be that of the state of the opening of main insolvency proceedings.

[39] Relevant recommendations and other provisions may be found throughout the Guide. Annex I of the Guide refers to them. Chapter XII of the UNCITRAL Legislative Guide on Secured Transactions could also be used for reference.

[40] A/CN.9/1088, para. 65 (c).

[41] See e.g. para. 470 of the Guide to Enactment of the UNCITRAL Model Law on Secured Transactions or paragraph 17 of Introduction to the UNCITRAL Legislative Guide on Secured Transactions.

[42] GEI, para. 241.

32. While leaving characterization of a right as a right *in rem* to the national law, some texts provide for an illustrative list of rights *in rem* referring in particular to: (a) the right to dispose of assets or have them disposed of and to obtain satisfaction from proceeds of or income from those assets, in particular by virtue of a lien or mortgage; (b) the exclusive right to have a claim met, in particular a right guaranteed by a lien in respect of the claim or by assignment of the claim by way of a guarantee; (c) the right to demand assets from, or require restitution by, anyone having possession or use of them contrary to the wishes of the party so entitled; (d) a right *in rem* to the beneficial use of assets; and (e) the right, recorded in a public register and enforceable against third parties, based on which a right *in rem* of creditors or third parties may be obtained.[43]

33. At its fifty-ninth session, the Working Group heard different views as regards approaches to treating rights *in rem* in insolvency proceedings, one of which is to subject rights *in rem* to *lex fori concursus,* while another is to insulate rights *in rem* from effects of any insolvency proceedings, except for avoidance actions. The latter approach in one surveyed text is accompanied by a safeguard aimed at preventing an abusive exploitation of "asset havens".[44] Because of observed pros and cons of those approaches, support was expressed for finding a middle ground, for example subjecting rights *in rem* to the effects of insolvency law of the State in which the asset is situated (*lex rei situs*; see Glossary, term (y)).[45]

34. The Working Group may wish to consider those aspects further, recalling issues raised in document A/CN.9/WG.V/WP.176, in particular that a proposal to include an exception to *lex fori concursus* for rights *in rem* did not receive sufficient support when the Guide was prepared.[46] A deviation from the approach taken to treating rights *in rem* when the draft Guide was prepared would be expected to be justified, for example with reference to the newly emerged needs or practices. In addition, it would be expected that the approaches to be taken would be consistent with other UNCITRAL texts, including the UNCITRAL Legislative Guide on Secured Transactions, which was prepared in parallel with the Guide and which reaffirms the application of *lex fori concursus* to security rights.[47]

35. A suggestion was made at the fifty-ninth session of the Working Group that the legislative provisions should explicitly provide that the commencement of insolvency proceedings should not displace the general, pre-insolvency conflict-of-laws rules applicable to the creation and effectiveness of a security right against third parties.[48] The secretariat notes that provisions to that effect are found in article 94 of the UNCITRAL Model Law on Secured Transactions and recommendation 223 of the UNCITRAL Legislative Guide on Secured Transactions.

---

[43] See e.g. article 8 of the EIR recast and Global Rule 15.

[44] See Global Rule 16 (to be read with Global Rule 15 that is similar to article 8 of the EIR recast). The safeguard displaces the exemption of rights *in rem* from the effects of insolvency proceedings if proof is provided that the State where the assets are situated, at the time of the opening of insolvency proceedings, has no substantial relationship to the parties or the transaction in relation to which the security right was created, and there is no other reasonable basis for the fact that the assets are so situated. It is for the party who claims that those conditions are met, in relation to a particular security right, to prove that those conditions are in fact met in the relevant case.

[45] A/CN.9/1088, para. 65 (c).

[46] See paras. 9, 10, 22 and 23 of document A/CN.9/WG.V/WP.176 in that respect.

[47] See recommendation 223 and chapter X, paras. 80–82. The commentary to article 94 in the Guide to Enactment of the UNCITRAL Model Law on Secured Transactions (para. 500) cross-refers to that recommendation and to recommendation 31 of the Guide.

[48] A/CN.9/1088, para. 87 (a).

Items (k) and (l). Rights and obligations of the debtor (see recs. 108–114, 284–287 and 289–290 of the Guide); and **Duties and functions of the insolvency representative** [or another independent professional] (see recs. 115–125 and 278 of the Guide)

36. At the fifty-ninth session of the Working Group, it was noted that practical difficulties arose from the application of article 24 of MLCBI that authorized the foreign representative, upon recognition of the foreign proceeding that it represents and subject to the requirements of the law of the recognizing State, to intervene in any proceedings in the recognizing State to which the debtor is a party. It was considered necessary to clarify whether it was *lex fori concursus* or the law of the recognizing State that would prevail with respect to power of attorney and other relevant issues. [49] As was explained at the session, problems arise because jurisdictions treat differently the debtor upon commencement of insolvency proceedings or recognition of a foreign insolvency proceeding. In some jurisdictions, the debtor may retain standing in the proceedings in which the debtor is a party, which might clash with *lex fori concursus* if the latter provided such standing only to the insolvency representative.

37. The Working Group may wish to consider those issues, noting that the commentary to article 24 of MLCBI explains that the purpose of that article is to avoid the denial of standing to the foreign representative to intervene in proceedings merely because the procedural legislation of the recognizing State may not have contemplated the foreign representative among those having such standing. [50] In all other respects, the local law would apply.

Item (n). Treatment of claims (recs. 169–184, 305 and 319–325 of the Guide)

38. The item encompasses identification of the claims that can or are required to be submitted, the treatment to be accorded to those claims, mechanisms for submission, verification and admission of claims, review of disputed claims and equal treatment of similarly ranked creditors. The item also covers the treatment of post-commencement claims addressed throughout the Guide (e.g. in the context of post-commencement finance).

39. At the fifty-ninth session of the Working Group, support was expressed for explicitly listing those aspects in the item and in addition to refer to creditors' rights after the closure of insolvency proceedings. [51] The latter suggestion may require further clarification because of its potential relevance to other items in the list (e.g. item (f) implementation of a reorganization plan and (s) discharge).

Item (o). Ranking of claims (see recs. 185–189 of the Guide)

40. At the fifty-ninth session of the Working Group, issues arising from the ranking of local and foreign claims were raised. [52] The Working Group may wish to note in that respect that paragraph 84 of the commentary to recommendations 30–34 of the Guide recommends treating the claim as an ordinary claim when equivalence cannot be established. Where the claims, given their essential content and function, correspond to each other to the extent that they can be considered "as functionally interchangeable", they should be considered equivalent and receive the same treatment in insolvency proceedings. The Working Group may wish to consider whether this issue falls within the scope of the project and if so, whether any further guidance on that point should be provided.

[49] A/CN.9/1088, para. 82.
[50] GEI, para. 204.
[51] A/CN.9/1088, para. 65 (d). Similar items are found in EIR recast, article 7(g), (h) and (k), respectively.
[52] A/CN.9/1088, para. 66 (b).

[Item (s *bis*). Liability of directors of the debtor for actions taken when the debtor was insolvent or in the period approaching insolvency, and the cause of action relating to that liability that could be pursued by or on behalf of the debtor's insolvency estate] (see part four and rec. 372 of the Guide)

41. At the fifty-ninth session of the Working Group, support was expressed for adding reference to directors' obligations and liabilities in the list of items.[53] It was however emphasized that such inclusion would be appropriate only if it was in line with part four. Part four notes that its focus is on those director obligations that may be included in the law relating to insolvency and become enforceable once insolvency proceedings commence (i.e. the liability of directors under criminal law or tort law or general company law of no relevance to insolvency is excluded).[54] In the light of the agreement reached about the broad interpretation of the term "insolvency law" in the chapeau provision of recommendation 31, it was however also considered that the need to amend further the list should not arise.[55]

42. The Working Group may wish to discuss further that suggestion in the light of issues raised in paragraphs 8–15 above, including whether a separate item on this matter should be included and, if so, whether the formulation of item (s bis) suggested above is acceptable.

[Item (s *ter*). [Restructuring] [Restructuring law]]

43. At the fifty-ninth session of the Working Group, support was expressed for adding reference to restructuring or restructuring law. Alternatively, it was suggested that a commentary might explain that the term "insolvency law" or "insolvency proceedings" found in the chapeau provisions captured restructuring aspects.[56] The Working Group may wish to consider those suggestions in the light of issues raised in paragraphs 8–15 above.

[Item (s *quater*). Environmental damages and liability]

44. At the fifty-ninth session of the Working Group, a suggestion was made to bring environmental aspects explicitly within the scope of *lex fori concursus* in the light of the most recent developments in case law.[57] Issues arising from environmental damages and liabilities in insolvency are multifaceted and cut across several existing items on the list (in particular, constitution and scope of the insolvency estate, stay of proceedings, use or disposal of assets, treatment of claims, treatment of contracts, rights and obligations of the debtor, duties and functions of the insolvency representative (or another independent professional) and discharge). In addition, they may touch upon aspects of public law, including international law, and hence application of overriding mandatory provisions of law.

45. The Working Group may wish to consider whether those aspects should be added specifically and if so, separately or in conjunction with any other item already found on the list in recommendation 31.

D. Exceptions to lex fori concursus

1. General

46. Consistent with recommendation 34 of the Guide and deliberations at the fifty-ninth session of the Working Group, the Working Group may wish to consider that the legislative provisions should provide for only limited number of exceptions

[53] A/CN.9/1088, para. 65 (e).
[54] See Background, para. 15.
[55] A/CN.9/1088, para. 68.
[56] A/CN.9/1088, para. 65 (f).
[57] A/CN.9/1088, para. 66 (a).

to *lex fori concursus* and those should be clearly set forth or noted in the insolvency law.

47. In that context, the Working Group may wish to recall that, at its fifty-ninth session, with reference to recommendation 34 of the Guide, a suggestion was made to reflect in the legislative provisions that exceptions to *lex fori concursus* would be found also in non-insolvency laws.[58] The Working Group may wish to consider that suggestion, noting that UNCITRAL insolvency texts usually recommend setting out or noting clearly in the insolvency law all provisions from other laws that have implications on insolvency proceedings.[59]

2. Payment and settlement systems and regulated financial markets

48. At its fifty-ninth session, the Working Group considered that, in the light of developments in financial markets and digitization of financial systems, an exception to *lex fori concursus* for payment or settlement systems and regulated financial markets found in recommendation 32 of the Guide would have to be updated.[60] In considering that aspect further, the Working Group may wish to note that, as was mentioned in paragraph 27 of document A/CN.9/WG.V/WP.176, the applicable law rule found in recommendation 32 is complementary to material rules found in recommendations 101 to 107 that provide for special treatment of financial contracts and netting in insolvency, exempting them from stay, ipso facto clauses and avoidance. As was noted in the Working Group, most recent texts addressing financial contracts and netting have shifted to some extent from the approach taken in recommendations 101 to 107.[61] The Working Group may wish to recall in that context that it had agreed that it was necessary to update that part of the Guide.[62]

49. During the discussion of recommendation 32, queries were raised with respect to the terms used in that recommendation, in particular reference to regulated financial markets. In considering this exception further, the Working Group may wish to note that UNCITRAL texts do not define those terms although the use of the word “regulated” is not uncommon.[63]

50. The understanding of the terms used in recommendation 32 may be assisted by recommendations 101–107 and their accompanying commentary in the Guide according to which the systems and markets intended to be covered are tightly integrated multilateral systems and markets where the insolvency of one participant could result in a series of defaults in back-to-back transactions, potentially causing financial distress to other system or market participants and in the worst case, the financial collapse of other counterparties, including regulated financial institutions. Inclusion of the word “regulated” in recommendation 32 may indicate that the exception applies, in addition to payment and settlement systems, only to regulated financial markets, i.e. those that would be subject to supervision or control by the regulatory authorities in the State under which law the market operates. The primary function of such regulatory authorities is to protect public interests. Regulated financial markets are thus unlike unregulated financial markets that are not so supervised or controlled although some aspects of their operation may be regulated.[64] Some suggest that the latter type of market may rapidly proliferate especially in the digital environment.

---

[58] A/CN.9/1088, para. 87 (b).

[59] See e.g. recommendation 66 and its accompanying footnote in that respect.

[60] A/CN.9/1088, para. 71.

[61] Ibid.

[62] See A/CN.9/WG.V/WP.176, para. 27 cross-referring to the report of the forty-fourth session of the Working Group (A/CN.9/798, paras. 26 and 30).

[63] See e.g. article 2(b) of the United Nations Convention on the Use of Electronic Communications in International Contracts and the commentary thereto; and article 4(2)(a) of the United Nations Convention on the Assignment of Receivables in International Trade.

[64] See e.g. Unregulated Financial Markets and Products – Financial Stability Board (fsb.org).

51. As was noted in paragraph 28 of document A/CN.9/WG.V/WP.176, article 12 of the EIR recast contains the same exception, which is made applicable also to avoidance of payment or transactions that took place in such systems or markets. In that context the EIR recast refers to payment or settlement systems and financial markets omitting a qualifier "regulated". Recital 71 relevant to those provisions notes the need for special protection in the case of payment systems and financial markets as well as the sale of securities and the guarantees provided for such transactions, indicating that, for such transactions, the only law which is relevant should be that applicable to the system or market concerned. It further notes that that law is intended to prevent the possibility of mechanisms for the payment and settlement of transactions being altered in the case of insolvency of a business partner. It notes in that context that special provisions of Directive 98/26/EC on settlement finality in payment and securities settlement systems take precedence. The referred Directive defines the systems as a formal arrangement between three or more participants with common rules and standardized arrangements for the clearing or execution of transfer order between the participants, and highlights systemic risks that such systems face. According to some commentary, the scope of application of article 12 is wider than that of the Directive, encompassing not only formal systems but all systems that are subject to the same systemic risks and require uniform treatment under only one law.[65]

52. The Working Group may wish to consider this exception in the light of those considerations and the cited objective to protect general confidence and certainty in the system or market intended to be covered and reduce systemic risk that such systems and markets face. The impact of applying a different law before and after insolvency of any participant in those systems or markets on the payment and settlement mechanisms used there may need to be assessed in that context. A deviation from the approach taken to drafting recommendation 32 would be expected to be justified, for example with reference to the newly emerged needs or practices. Where the exception is to stay, the Working Group may wish to consider whether the word "regulated" should be deleted or should be kept and if so, whether it should be kept as a qualifier with respect to only "financial markets" or also "payment and settlement systems".

3. Labour contracts

53. At its fifty-ninth session, the Working Group heard different views on whether the application of the exception to *lex fori concursus* should be made unconditional for labour contracts,[66] following the approach taken in article 13(1) of the EIR recast. It should be noted that the EIR recast refers in that context to the effects of insolvency proceedings on employment contracts and relationships with recital 72 clarifying that the reference is to continuation or termination of employment, the rights and obligations of all parties to such employment and the need to seek approval for termination of employment contracts, where required. The EIR recast leaves other effects of insolvency proceedings on employment contracts and relationships, such as submission, verification, admission and ranking of employment claims to *lex fori concursus* (with the exception of the cases where undertakings are given to avoid the opening of secondary insolvency proceedings (those aspects are expected to be considered by the Working Group at a later stage[67])). Global Rule 20 is similar to article 13(1) of the EIR recast but Global Rule 21 makes it clear that avoidance of labour contracts would also fall under *lex fori concursus*.[68]

54. The Working Group may wish to consider this exception in the light of its drafting history (A/CN.9/WG.V/WP.176, paras. 29 and 30), in particular the objective of preserving flexibility necessary to accommodate different circumstances. It has been suggested that some circumstances may require applying rules of labour law of a particular jurisdiction, which would not necessarily be the law of the State where

[65] Brinkmann, p. 149.
[66] A/CN.9/1088, paras. 73–77.
[67] A/CN.9/1088, para. 80.
[68] See the Reporters' Notes to Global Rules 20 and 21.

insolvency proceedings are commenced or the law of the labour contract chosen by parties. It may not be excluded that several laws may need to be applied to different aspects of employment contract (*dépeçage*). Additional safeguards that a public policy exception discussed in section E below may offer are also relevant in this context. A deviation from the approach taken to drafting recommendation 33 would be expected to be justified, for example with reference to the newly emerged needs or practices.

E. Public policy exception and other provisions

55. Consistent with the approach taken in other UNCITRAL insolvency texts,[69] the legislative provisions may include a public policy exception, which would aim at allowing courts in the enacting State to disapply a foreign law if applying that law would be manifestly contrary to the public policy of that State. As was noted at the fifty-ninth session of the Working Group, the need for inclusion of such a provision would depend on the form of the legislative provisions, and the Working Group would thus consider it at a later stage.[70] Where it would be included, the Working Group may wish to consider that it would be consistent with the UNCITRAL practice to recommend that States should interpret the exception narrowly and restrictively and invoke it only under exceptional circumstances concerning matters of fundamental importance for the enacting State.[71]

56. Depending on the eventual form of the legislative provisions, inclusion of some other provisions may need to be considered in due course, such as provisions on primacy of international obligations and on interpretation of the legislative provisions in the light of their international origin and the need to promote uniformity in their application and observance of good faith.[72]

---

[69] See e.g. article 6 of MLCBI, article 7 of MLIJ and article 6 of MLEGI.
[70] A/CN.9/1088, para. 90.
[71] See e.g. GEI, para.104.
[72] See e.g. articles 3 and 8 of MLIJ.