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Insolvency Law

Background information on topics comprising the current mandate of Working Group V and topics for possible future work

Note by the Secretariat

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Introduction

1. In July 2013, the Commission adopted the Guide to Enactment and Interpretation of the UNCITRAL Model Law on Cross-Border Insolvency (the UNCITRAL Model Law), which includes new material on aspects of the concept of "centre of main interests" and part four of the UNCITRAL Legislative Guide on Insolvency Law (the UNCITRAL Insolvency Guide), which addresses the obligations of directors in the period approaching insolvency. The Commission noted, however, that the current mandate of Working Group V as it related, inter alia, to "centre of main interests", had not been exhausted by completion of the Guide to Enactment and Interpretation and that issues relating to enterprise groups remained. The Commission agreed that Working Group V (Insolvency Law) should hold a colloquium in the first few days of the working group session scheduled for the second half of 2013 to clarify how it would proceed with the enterprise group issues and other remaining parts of its current mandate. It should also consider topics for possible future work, including insolvency issues specific to micro, small and medium-sized enterprises. The conclusions of the colloquium would not be determinative but should be considered and evaluated by the Working Group in the remaining days of that session, in the context of the existing mandate. Topics identified for possible future work should be reported to the Commission in 2014.[1]

2. This note by the Secretariat provides (a) background information on topics that form part of the current mandate of Working Group V and references to relevant UNCITRAL documents; and (b) information and proposals on topics that might form the basis of possible future work on insolvency law.

I. Working Group V's current mandate

A. Facilitating the cross-border insolvency of multi-national enterprise groups

1. UNCITRAL references

UNCITRAL Legislative Guide on Insolvency Law, part three

UNCITRAL Practice Guide on Cross-Border Insolvency Cooperation

A/CN.9/WG.V/WP.74/Add.2, paragraphs 5-12

A/CN.9/WG.V/WP.76/Add.2, paragraphs 2-17

A/CN.9/WG.V/WP.82/Add.4, paragraphs 10-15

A/CN.9/WG.V/WP.85/Add.1, paragraphs 3-13

A/CN.9/WG.V/WP.99, paragraphs 55-64

A/CN.9/618, paragraph 54

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[1] *Official Records of the General Assembly, Sixty-eighth Session, Supplement No. 17*, (A/68/17), para. 326.

A/CN.9/666, paragraphs 26-27

A/CN.9/671, paragraphs 18-23

A/CN.9/738, paragraphs 36-37

A/CN.9/WG.V/WP.114

2. Background

3. In 2006, a proposal noted that since the business of corporations is increasingly conducted, both domestically and internationally, through enterprise groups, they are an important feature of the global economy and significant to international trade and commerce. In response, Working Group V commenced work in the area of the treatment of enterprise groups in insolvency. Notwithstanding that significance to international trade, and the importance not only of knowing how a group will be treated in insolvency if its business fails, but also of fast and efficient mechanisms for the resolution of its financial difficulties, the proposal also noted that very few, if any, States recognized enterprise groups as distinct legal entities or had a comprehensive regime for their treatment in insolvency.

4. The Commission adopted part three of the UNCITRAL Legislative Guide, which specifically addresses the treatment of enterprise groups in insolvency, both domestically and in a cross-border context, in 2010.

5. Following the completion of part three, Working Group V was given a mandate to consider selected aspects of the concept of "centre of main interests" (COMI) as used in the UNCITRAL Model Law with a view to providing more guidance and information on its interpretation and application. At its forty-second session (2012), the Working Group expressed the following views: it was necessary to look at the issue of COMI as it related to enterprise groups because most commercial activity was currently conducted through such groups; the scope of its mandate with respect to COMI as originally approved included COMI in the context of enterprise groups; and that that topic should be considered upon completion of the revisions proposed for the Guide to Enactment of the Model Law (A/CN.9/763, paras. 13-14).

6. Document A/CN.9/WG.V/WP.114 (forty-third session of the Working Group) provides a summary of the working papers considered by previous working group sessions with respect to the idea of determining the COMI or a coordinating centre for enterprise groups, particularly in the cross-border context, and the conclusions of the Working Group on those papers. It is not possible to repeat that material in this note, however the conclusions reached by the Working Group highlight the difficulties of applying that notion to enterprise groups and account for the approach adopted in part three of the Legislative Guide of focusing on cooperation and coordination in cross-border proceedings involving enterprise groups.

B. Convention on selected international insolvency issues[2]

1. UNCITRAL references

A/CN.9/686

A/CN.9/WG.V/WP.93/Add.6

UNCITRAL Legislative Guide on Insolvency Law, part two, chapter 1, paragraphs 80-91 and recommendations 30-34

UNCITRAL Legislative Guide on Secured Transactions, chapter XII, paragraphs 14-17 and recommendation 223

2. Background

7. At its thirty-seventh session (2009), the Working Group had before it:

> "127. … a proposal by the Union Internationale des Avocats (UIA) on a possible international convention in the field of international insolvency law, which might cover the following issues:
>
> (a) Granting of access to courts to foreign insolvency representatives;
>
> (b) Recognition of foreign insolvency proceedings (with the effect of granting the foreign proceeding the rights of a national proceeding or triggering a secondary proceeding); and
>
> (c) Cooperation and communication between insolvency representatives and courts.
>
> "128. If agreement on those issues seemed possible, the proposal suggested the international convention might also contain provisions on:
>
> (a) Direct competence ("convention double")[for the opening of insolvency proceedings, whether main or non-main];
>
> (b) Applicable law ("convention triple", could be part of a separate protocol)."[3]

8. Support was expressed by the Working Group in favour of the goal of developing an international convention, but there were reservations with respect to the feasibility of reaching agreement, particularly in view of the difficulties encountered in the past in the area of international insolvency law.

9. At its thirty-eighth session (2010), and in the context of further consideration of topics for possible future work, the Working Group noted the connection between a proposal to undertake work on providing more guidance and information on the concept of COMI as used in the UNCITRAL Model Law (the project undertaken as revisions to the Guide to Enactment of the Model Law adopted by the Commission in 2013) and the proposal to develop a convention. There was considerable support

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[2] This topic was originally proposed by the Union Internationale des Avocats (UIA) and supported by the International Bar Association (IBA). The material included in this paper has been revised to include additional material provided by the UIA and by the IBA.

[3] Report of Working Group V (Insolvency Law) on the work of its thirty-seventh session (A/CN.9/686).

for the view that, in line with the approach adopted in previous work of the Working Group, the topics could be approached in a manner that would not preclude the development of a convention. The mandate given by the Commission in 2010 reflects that possibility.[4]

10. At its thirty-eighth session, the Working Group also had before it comments provided by the International Bar Association (IBA) on the UIA proposal (A/CN.9/WG.V/WP.93/Add.6), expressing the global legal profession's support of that proposal for an international insolvency convention to encourage judicial and administrative cooperation and coordination in cross-border insolvency cases, including enterprise group cases. The IBA has noted that breakdowns of international cooperation in cross-border insolvency cases continue despite the UNCITRAL Model Law, and threaten the progress of international trade and economic development. Cross-border judicial and administrative conflicts often result in job losses, erosion of enterprise value, misallocation of assets and costly cross-border litigation. Court-to-court communication and cooperation guidelines and similar aids, while extremely useful, are not consistently employed. These challenges could effectively be addressed by an insolvency convention primarily focused on procedural issues such as cross-border recognition, enforcement of orders, judicial and administrative communication and cooperation, and so forth.

11. Further material prepared by the UIA notes the following points:

(a) Due to the differences between insolvency regimes of the several States, the UNCITRAL Model Law on Cross-Border Insolvency has been incorporated into domestic legal systems of the States to a limited extent. Faced with this problem, an international convention[5] would be the most appropriate technical regulation to harmonize and codify international insolvency law, facilitating the mutual recognition of foreign insolvency proceedings in different Contracting States;

(b) The need for an international convention has become even more apparent in the course of insolvency proceedings affecting corporate groups. The absence of binding instruments to regulate the international aspects of enterprise group

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

[5] The Working Group may wish to recall that throughout the preparatory work for the Model Law, the drafters proceeded on the assumption that the final text would be a model law rather than a convention. One reason for this approach was the close relationship between insolvency law and national judicial and civil procedure laws, which varied greatly from State to State. A second reason was the desire to complete the work in 1997; there was a general recognition at the thirtieth session of the Commission in 1997 when the Model Law was finalized that negotiation of a treaty would require more work, was technically much more difficult than a model law and the resulting text would not only prove difficult to accept, requiring a more complicated adoption procedure, but would not provide any short term improvement in the cross-border insolvency situation. The International Bar Association, in particular, noted the lack of success to date in achieving broad multilateral treaties in the area of cross-border insolvency and that "prospects for adopting legislation that would genuinely improve the real world of cross-border insolvency lay in model legislative provisions" (UNCITRAL Yearbook Vol. XXVIII: 1997, Part Three, para. 41, p. 341). Other delegates felt that adoption of the model provisions should precede any consideration of the feasibility of preparing a treaty. In adopting the Model Law, the Commission decided that it should evaluate the impact of, and its experience with, the Model Law before making a decision to draft a treaty (UNCITRAL Yearbook Vol. XXVIII: 1997, Part Two, para. 20, p. 47). No further action has been taken in that regard to date.

insolvency hampers homogeneous solutions by applying national law of States which is not conducive to proper development of cross-border insolvency proceedings and reorganization plans of the group companies. An international convention would provide solutions within enterprise groups since it would allow the recognition of foreign proceedings, access for insolvency representatives to the courts of other Contracting States and cooperation and coordination between the various procedures for insolvency of corporate groups;

(c) The starting point for the elaboration of an international convention would be the articles of the UNCITRAL Model Law and its Guide to Enactment and Interpretation, which could be combined with the recommendations contained in the UNCITRAL Legislative Guide, including the provisions of part three relating to the treatment of enterprise groups in insolvency. These preliminary works for the convention could be considered in conjunction with other reference texts on the subject, such as the European Council (EC) Regulation No. 1346/2000 of 19 May 2000 on insolvency proceedings, which has proven to be extremely useful and effective in the European Union;

(d) The degree of consensus in Working Group V on UNCITRAL texts already adopted in the field of cross-border insolvency has facilitated the creation of an *opinio juris* required for the development of an international convention;

(e) Particularly in the international context, the approach of soft law has reached its limits of effectiveness. The global crisis has shown that binding legal instruments are needed to provide greater assurance and legal certainty in cross-border insolvency situations, especially in proceedings involving international enterprise groups; and

(f) While Working Group V of UNCITRAL is the most competent and appropriate international body to take up the development of this international convention, cooperation and coordination with other international and regional expert organizations, such as the Hague Conference on Private International Law and with the European Commission, would be required.

12. The proposal by the UIA has been supplemented by a proposal by the International Insolvency Institute (III) on the specific question of choice of law in cross-border bankruptcy cases, which raises the following additional points.

13. A harmonized approach to choice of law issues in cross-border insolvency cases has the potential to significantly improve the coordination of liquidation and rescue of cross-border enterprises. Key topics that might be addressed first could be applicable law for ranking unsecured claims or choice of law for intellectual property or other intangible property rights. These issues have been raised in many cross-border insolvency cases and serious problems in the consistency and predictability of approaches persist. Although short of harmonizing substantive insolvency rules, harmonization of choice of law rules in cross-border insolvency cases would result in increased consistency, certainty, and predictability and improve and rationalize the content of the relevant choice of law rules.

14. Such work could complement UNCITRAL's ongoing project to improve the coordinated administration of cross-border cases as reflected in the UNCITRAL Model Law and the UNCITRAL Legislative Guide. Broad deference to the law of the debtor's COMI may facilitate coordinated governance by centralizing the

administration and governance of an insolvency case, but also has the potential to export loss allocation policies across national borders. A broad scope for the application of local law may frustrate the administration of an insolvency case, but limits the extent to which the choice of insolvency forum will disrupt the nationally determined entitlements. Possible approaches might seek to distinguish "procedural" insolvency rules from those that affect substantive entitlements, or to identify particular matters where local interests dominate.

15. The work might first explore when the law of the forum would conclusively determine the governing insolvency principles (whether that forum was a main or non-main proceeding). It might then consider when the forum court in a non-main proceeding should apply the insolvency law of the main proceeding and identify other circumstances where a forum court might defer to the insolvency law of another jurisdiction (whether or not a proceeding was pending in that other jurisdiction). Ordinary private international law principles might continue to govern questions of non-insolvency law such as the validity or non-validity of claims.

16. This work could interact with and reinforce the work to be undertaken on the application of COMI to enterprise groups. It could also facilitate the adoption of the Model Law and its underlying principles. To the extent that the law of the main forum determines the law for the group, coordination is facilitated. Narrower application may minimize the extent to which local entitlements and policies are displaced and encourage cooperation, but may make coordination more difficult. While it is suggested that UNCITRAL is uniquely situated to undertake such a project, given its experience and expertise in the area of insolvency law, work on this topic could be conducted in coordination with other international organizations with expertise in the area of choice of law, such as the Hague Conference on Private International Law.

C. Insolvency of large and complex financial institutions

1. UNCITRAL references

A/CN.9/WG.V/WP.93/Add.5

A/CN.9/709

A/CN.9/WG.V/WP.109

A/CN.9/WG.V/WP.118

2. Background

17. At its forty-third session (2010), the Commission discussed a proposal by the Delegation of Switzerland to study the feasibility of developing an international instrument regarding the cross-border resolution[6] of large and complex financial institutions (A/CN.9/WG.V/WP.93/Add.5 and A/CN.9/709, para. 5). It was agreed

[6] Where "resolution" means the restructuring of an institution in order to ensure the continuity of its essential functions, preserve financial stability and restore the viability of all or part of that institution.

that the Secretariat should prepare a comprehensive report on all or any of a number of issues.[7]

18. A first note prepared by the Secretariat focuses on paragraph (c) of the proposal and outlines the work undertaken (and ongoing) by international organizations (namely the Financial Stability Board (FSB), Basel Committee on Banking Supervision (BCBS) and the International Monetary Fund (IMF)), and regionally in the European Union. It also considers the relationship between that work and the completed work of UNCITRAL, both in the cross-border field and as it relates to enterprise groups. It does so against the backdrop that financial institutions are currently excluded from the scope of all relevant instruments adopted by UNCITRAL. A second note by the Secretariat, providing updated information on the work reported in the first paper has been prepared for the forty-fourth session of the Working Group (A/CN.9/WG.V/WP.118).

19. The first note highlights in particular the practical relevance of the "Key Attributes of effective resolution regimes for financial institutions" (Key Attributes)[8] developed by the FSB and endorsed by the G20 in 2011.[9] The Key Attributes seek to establish international standards for effective resolution regimes and encourage international convergence, calling for legislative changes in many jurisdictions in order to implement them. Key Attribute 7.5 contains a specific rule on cross-border recognition and cooperation, which includes the following language:

> "Jurisdictions should provide for transparent and expedited processes to give effect to foreign resolution measures, either by way of a mutual recognition process or by taking measures under the domestic resolution regime that support and are consistent with the resolution measures taken by the foreign home resolution authority. Such recognition or support measures would enable a foreign home resolution authority to gain rapid control over the firm (branch or shares in a subsidiary) or its assets that are located in the host jurisdiction, as appropriate, in cases where the firm is being resolved under the law of the foreign home jurisdiction. [...]"

20. Despite the widely acknowledged relevance of the issue, no concrete steps with tangible results have been taken so far to further develop such a legal

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[7] These issues included: "(a) Identify the issues relevant for and particular to the winding down of large and complex financial institutions; (b) Establish a comparative study of selected legal orders in respect of mechanisms to ensure cooperation across borders in the course of a winding down of large and complex financial institutions; (c) Establish and summarize the work undertaken or being undertaken by other institutions, as well as the contents of any such work in this area; (d) Identify areas and legal issues where the principles established in the 2004 UNCITRAL Legislative Guide on Insolvency Law and the 1997 UNCITRAL Model Law on Cross-Border Insolvency could or should be applied directly or by analogy; (e) Identify possible alternative approaches for facilitating and ensuring cooperation across borders in the course of a winding down of large and complex financial institutions; (f) Issue recommendations in respect of possible future work by UNCITRAL or other bodies as well as national legislators or regulating authorities in the fields identified."

[8] www.financialstabilityboard.org/publications/r_111104cc.pdf (07/10/2013).

[9] Building on this decision, the G20 Leaders' Declaration of 6 September 2013 stated: "We renew our commitment to make any necessary reforms to implement fully the FSB's Key Attributes [...]. We will undertake the necessary actions to remove obstacles to cross-border resolution [...]" www.g20.org/documents/ (07/10/2013)), para. 68.

framework at a global level. At a regional level, the EU Winding-up Directive[10] provides for the mutual recognition and enforcement in all EU Member States of decisions concerning the reorganization or winding up of banks and insurance undertakings having branches in Member States other than those in which they have their head offices. Also, the draft EU Recovery and Resolution Directive[11] provides for a recognition mechanism between the EU and third countries in the future.

21. The disorderly dismantling of financial institutions has proven to cause significant damage to States' economies. As an effective cross-border resolution mechanism has the potential to limit such damage in the future, devising such a mechanism at a global level seems highly desirable. That mechanisms should provide a legal framework enabling jurisdictions to give effect to foreign resolution measures concerning distressed financial institutions. Other issues of cross-border coordination among supervisory authorities, as well as regulatory particularities applying exclusively to systemically important financial institutions (SIFIs), should be left outside the scope of any future instrument. A non-binding instrument in the form of a model law or recommendations as part of (or as an addendum to) a legislative guide might be the most appropriate approach in order to achieve consensus.

22. It is suggested that since UNCITRAL has some 20 years of experience in cross-border insolvency issues and its legislative expertise and working methods have stood the test of ambitious topics that are both technically challenging and politically sensitive, it seems to be the body best suited to devise a legal framework for the cross-border resolution of financial institutions. Work undertaken on this topic may be based upon UNCITRAL's previous projects, as well as on work by other institutions and involve close coordination and cooperation with other international expert bodies.

D. Obligations of directors of enterprise group companies in the period approaching insolvency

1. UNCITRAL references

A/CN.9/WG.V/WP.115

UNCITRAL Legislative Guide on Insolvency Law, part four

2. Background

23. Part four of the UNCITRAL Legislative Guide, which was adopted by the Commission in 2013, addresses the obligations of directors of a single entity in the period approaching insolvency. It does not address the application of those obligations in the enterprise group context.

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[10] Directive 2001/24/EC of the European Parliament and of the Council of 4 April 2001 on the reorganization and winding up of credit institutions, available from http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32001L0024:EN:NOT.

[11] Proposal for a Directive of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms, http://register.consilium.europa.eu/pdf/en/13/st11/st11148-re01.en13.pdf (07/10/2013).

24. At its forty-second session (2012), the Working Group considered issues relating to directors of enterprise group members (A/CN.9/763, para. 92). It was agreed that although the topic raised difficult and complex issues, particularly in the nexus of insolvency and corporate law, once the Working Group had completed its consideration of those issues in the context of individual companies, the possibility of further work in this area should be given serious consideration. Information concerning the manner in which national legal regimes treated directors' obligations was provided for the forty-third session (2013) of the Working Group (see A/CN.9/WG.V/WP.115).

25. Since much of modern business is conducted through enterprise groups, which often require directors to balance the interests of their own company with those of the group as a whole, it may be appropriate to consider the impact of the enterprise group structure on the obligations set out in part four of the Legislative Guide. A different approach might be required, one that is moderated, for example, by acknowledging the existence of the group, its structure, and the realities of its daily operations — in other words, an approach that takes account not only of the best interests of the individual constituent entities of the group, but also of how those interests fit within the interests of the group enterprise as a whole, and achieves a balance between those two considerations.

II. Topics for possible future work

A. Issues relating to creditors and claims

1. Global standards for claims adjudication

(a) Background

26. The existing inconsistency among procedures in different jurisdictions creates uncertainty for debtors and creditors alike (especially where more than one jurisdiction may be available for a particular claims dispute), difficulty for judges and practitioners, and doubts about the enforceability (and recognizability) of a judgement from a court in one jurisdiction in another jurisdiction that follows a different standard. The issue has been a major consideration in large, multi-jurisdictional insolvency proceedings like that of Lehman Brothers.

27. Working toward a global, standard process would foster efficiency and certainty in insolvency matters worldwide and in the global restructuring and insolvency industry.

2. Ranking of creditors' claims[12]

(a) UNCITRAL references

UNCITRAL Legislative Guide on Insolvency Law, part two, chapter V, paragraphs. 62-79 and recommendations 189 and 190

[12] This topic is proposed by INSOL International.

(b) Background

28. Standardized guidelines for ranking claims of different character and the treatment of "unusual" creditors (e.g., pension funds, employees, deposit insurance funds) would assist in the adjudication of bankruptcy and insolvency matters. There currently is no consistency in this area among countries — in fact, some countries grant extraordinary rights to certain "unusual" creditors that significantly alter the "waterfall" priority schemes that would otherwise apply (and still do apply in other countries).

29. Political factors in some jurisdictions may make it unlikely that a completely uniform global standard could be adopted; nonetheless, developing general guidelines would help to instil greater certainty in bankruptcy and insolvency proceedings and to protect against creditors' rights varying wildly from jurisdiction to jurisdiction.

3. Relative voting rights of debt and equity holders[12]

(a) UNCITRAL references

UNCITRAL Legislative Guide on Insolvency Law, part two, chapter IV, paragraphs 26-55 and recommendations 145-151

(b) Background

30. Voting rights of debt and equity holders on a reorganization plan differ significantly between some jurisdictions and may lead to forum-shopping and uncertain enforceability of those plans from jurisdiction to jurisdiction. In particular, when one country's insolvency scheme permits a "cram down" non-consensual reorganization (i.e., over the dissenting vote of a class of creditors or equity holders), and another country's does not, the question of whether a reorganization plan based on that scheme should be recognized by a court in the other country may be a significant question in certain multinational insolvency proceedings. In addition, when one country's insolvency regime does not distinguish between the voting rights attached to the debt claims of third-party creditors and those of insiders, and another country's does, the question of whether a reorganization should be recognized by a court in the other country likewise may be a significant one.

31. In the recent cross-border case of *In re Vitro S.A.B. de C.V. (Vitro, S.A.B. de C.V. v. ACP Master, Ltd)*, the United States court found that several provisions in a confirmed Mexican reorganization plan that extinguished the note holders' claims against non-debtor subsidiaries and against guarantors of the notes were manifestly contrary to fundamental policies of the United States regarding protection of third-party claims in the context of insolvency. While the Mexican proceedings were recognized as foreign proceedings under the legislation implementing the UNCITRAL Model Law in the United States (chapter 15 of the Bankruptcy Code), the court declined to enforce the reorganization plan on the basis that it deviated from fundamental public policies of the United States.

32. Guidance as to appropriate guidelines for relative voting rights (and the deference to be afforded another jurisdiction's scheme) could avoid disputes over difficult questions in some insolvency proceedings.

4. Coordinating creditor access to information and collective representation[13]

(a) UNCITRAL references

UNCITRAL Legislative Guide on Insolvency Law, part two, chapter III, paragraphs 75-115 and recommendation 126-136

(b) Background

33. One goal that is shared among insolvency regimes is maximizing creditor recoveries. A related goal is providing creditors with access to information so that they may participate in the case and protect their individual interests and the interests of similarly situated creditors. While some creditors may have access to an insolvency representative locally, creditors that are geographically distant from the local proceeding may not have such access or the knowledge as to how to gain access to the case, the representative or information about the status of the case. Additionally, in some jurisdictions, the representative may not be required to communicate with creditors, making the process appear opaque. A number of jurisdictions have a well-established approach through the appointment of official committees of creditors to represent the collective interests of unsecured creditors or other types of collective representation, albeit with different guidelines for the appointment of creditors to such committees. In the case of concurrent proceedings for the same debtor or related cross-border proceedings for members of an enterprise group, while the UNCITRAL Model Law addresses cooperation between the courts and between foreign representatives, it does not address cooperation between creditor representatives (official or unofficial). Recommendations 126-136 of the UNCITRAL Legislative Guide, which address the participation of creditors in insolvency proceedings, have been followed in only a limited number of insolvency laws. A coordinated approach to creditor access and, where appropriate, collective representation could ensure the free flow of information, encourage creditor participation and maximize recovery as well as transparency.

34. Working Group V might consider developing a coordinated approach to creditor access to insolvency representatives with the goal of maximizing creditor access to information and participation. That work could expand upon recommendations 126-136 of the UNCITRAL Legislative Guide or possibly be developed into a best practices guide. It might also be included in the Guide to Enactment and Interpretation of the UNCITRAL Model Law in the paragraphs addressing cooperation under article 27. Alternatively, this issue could be addressed as part of future work on the insolvency of enterprise groups.

B. Insolvency treatment of financial contracts and netting[14]

1. UNCITRAL references

UNCITRAL Legislative Guide on Insolvency Law, part two, chapter II, paragraphs 208-215 and recommendations 71, 92 and 101-107

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[13] This topic is proposed by the International Women's Insolvency and Restructuring Confederation (IWIRC).

[14] This topic is proposed by the World Bank.

2. Background

35. An efficient legal treatment of financial contracts is essential for the proper functioning of the financial markets. It is regarded as imperative that there be certainty as to what happens when one of the parties to such contracts fails to perform, including for reasons of insolvency, and it is generally thought that such contracts should receive special treatment and protection in the event of insolvency. However, such special treatment may conflict with other objectives of insolvency law. Additionally, the global financial crisis showed that the approach of isolating financial contracts from the effects of the insolvency process is not exempt of controversy.

36. The traditional protective approach to financial contracts is also taken by the UNCITRAL Legislative Guide. The Legislative Guide (a) exempts financial contracts (broadly defined) from the operation of any stay imposed on the termination of contracts or of any limitations on the enforceability of contract clauses that automatically terminate or accelerate a contract upon commencement of insolvency proceedings (ipso facto rules); (b) further exempts such contracts of any limitations on the exercise of set-off rights and netting upon commencement of insolvency proceedings; (c) limits the application of avoidance rules in this regard; and (d) exempts security interests to obligations arising out of financial contracts from any stay that applies to the enforcement of a security interest. These exemptions apply whether or not one of the counterparties to the contract is a financial institution (see recommendations 71, 92, 101-107). The main rationale offered by the Legislative Guide for these exemptions is the reduction of systemic risk that could threaten the stability of financial markets and that may be the outcome if debtors are allowed to "cherry-pick" contracts by performing some and breaching others and if there is legal uncertainty regarding the effect of insolvency upon financial contracts.

37. It seems timely to re-examine this axiom, taking stock of the experience brought by the financial crisis and the accumulated practice in different legal regimes applying safe harbours for financial contracts. An important development that might affect this issue is the evolving standard for regimes governing the resolution of financial institutions. These standards include certain restrictions upon the operation of rights under financial contracts so that they do not hamper the effective implementation of resolution measures (see Financial Stability Board, Key Attributes of effective resolution regimes for financial institutions, Part 4 and Annex IV;[15] see also Unidroit Principles on the Operation of Close-out Netting Provisions, Principles 7 and 8[16]). Insolvency exemptions afforded to financial contracts that are applied broadly might be counterproductive in other restructuring contexts as well.

38. In the context of the UNCITRAL Legislative Guide, the key question might be whether it strikes a proper balance between the preservation of the net social benefit of financial contracts and the reduction of the potential harmful effect of immunizing such contracts from various insolvency rules. In this respect, the

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[15] Available from www.financialstabilityboard.org/publications/r_111104cc.pdf.

[16] Available from www.unidroit.org/english/governments/councildocuments/2013session/cd92-06a-e.pdf.

specific implications of the special treatment afforded to financial contracts in the event of insolvency might be considered, including:

(a) The risk that creditors who are not true financial counterparties side step the insolvency process;

(b) Possible disincentives to monitor the credit strength of trading partners;

(c) The potential incentive to frame transactions as financial contracts and obtain a de facto undisclosed security interest;

(d) The potential unfairness to the general body of creditors (i.e. inequitable distribution of insolvency loss) and harm to the estate;

(e) The risk of abuse of the insolvency process by "empty creditors" (whose economic interests diverge from their right to vote their claim) and potential harm to restructurings attempts; and

(f) The risk of expansion of exemptions beyond their intended scope.

C. Regulation of insolvency practitioners[12]

1. UNCITRAL references

UNCITRAL Legislative Guide on Insolvency Law, part two, chapter III, paragraphs 36-43 and 48 and recommendations 115-117

2. Background

39. In 2007, the European Bank for Reconstruction and Development (EBRD) identified a set of principles to guide lawmakers in setting standards for the qualifications, appointment, conduct, supervision and regulation of insolvency office holders. These Insolvency Office Holder Principles[17] seek to advance the integrity, fairness and efficiency of the insolvency law system by ensuring that appropriately qualified professionals hold office in insolvency cases. These guidelines provide a checklist of most of the major issues which should be reflected in any insolvency law regime that provides for the appointment of an office holder in insolvency or reorganization cases: to this extent they are not intended to be exhaustive. As such, they build on the relevant provisions of the UNCITRAL Legislative Guide and the World Bank Principles for Effective Insolvency and Creditor Rights Systems,[18] by providing greater detail and guidance on the application of the standards advanced by those institutions.

40. Despite the differences of legal systems, insolvency office holders, variously called trustees, administrators, receivers, liquidators, insolvency representative, are a critical aspect of the institutional capacity that determines the effectiveness and efficiency of most insolvency systems around the world. They are required to act

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[17] Available from www.ebrd.com/downloads/legal/insolvency/ioh_principles.pdf. www.google.at/search?q=EBRD+Insolvency+Office+Holder+Principles&rls=com.microsoft:en-gb:IE-SearchBox&ie=UTF-8&oe=UTF-8&sourceid=ie7&rlz=1I7GGHP_en - #.

[18] World Bank Principles for Effective Insolvency and Creditor Rights Systems, available from http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/LAWANDJUSTICE/GILD/0,,pagePK:181022~theSitePK:215006,00.html.

honestly, professionally and responsibly. They are usually given control over assets and significant authority to decide how and when assets are managed, realized and distributed. A properly qualified, trained and regulated cadre of office holders is essential for the transparent, effective and efficient functioning of these systems. Assessments and surveys demonstrate, however, that many insolvency law regimes are lacking the core elements necessary for the proper functioning of such a system.

41. Consideration could be given to developing these Principles for international application.

D. Enforcement of insolvency-derived judgements[12]

1. UNCITRAL references

UNCITRAL Model Law on Cross-Border Insolvency, article 21 and Guide to Enactment and Interpretation, paragraphs 189-195

UNCITRAL Model Law on Cross-Border Insolvency: the Judicial Perspective (2012 version), paragraphs 138-146

CLOUT case no. 1270: *Rubin v Eurofinance SA*

2. Background

42. In *Rubin v Eurofinance SA*,[19] the foreign representatives of the debtor company sought, in addition to recognition of the foreign proceedings, enforcement of a judgement issued by the United States Bankruptcy Court against third parties for a payment due to the creditors of the debtor company. On an appeal against a decision of the Court of Appeal that the judgement could be enforced, the English Supreme Court addressed the principal issue of whether the recognition and enforcement of judgements given in the course of insolvency proceedings (e.g. judgements in transaction avoidance proceedings) were subject to the traditional common law rules governing the recognition of *in personam* and *in rem* judgements, or whether different rules applied to insolvency judgements. The court found that different rules did not apply and that the Cross-Border Insolvency Regulations 2006 (CBIR) (enacting the Model Law in Great Britain) did not provide for recognition and enforcement of foreign judgements against third parties. The court said that it would be surprising if the Model Law was intended to deal with judgements in insolvency matters by implication. Articles 21, 25 and 27 of the UNCITRAL Model Law were concerned with procedural matters and while there was no doubt they should be given a purposive interpretation and be widely construed in the light of the objects of the Model Law, the court said there was nothing to suggest that they applied to the recognition and enforcement of foreign judgements against third parties. The court went on to observe that the Model Law was not designed to provide for the reciprocal enforcement of judgements.

43. Thought might be given as to whether the UNCITRAL Model Law should specifically cover the enforcement of insolvency-derived judgements as part of the heads of discretionary relief available under article 21. Consideration might also be

[19] [2012] UKSC 46 (on appeal from [2010] EWCA Civ 895 and [2011] EWCA Civ 971); CLOUT case no. 1270.

given as to whether the standard text of the Model Law should include something along the lines of "proceedings concerning the adjustment of debt" in the definition of "foreign proceedings" to mirror proposed changes to the European Council (EC) Regulation No. 1346/2000 of 29 May 2000 on insolvency proceedings, as well as the manner in which the Model Law has been enacted in some States. Such a revision would assist with the cross-border recognition of voluntary restructuring agreements.

E. Treatment of intellectual property contracts in cross-border insolvency cases[20]

1. UNCITRAL references

UNCITRAL Legislative Guide on Insolvency Law, part two, chapter II, paragraph 115

UNCITRAL Legislative Guide on Secured Transactions: Supplement on Security Rights in Intellectual Property (2011)

2. Background

44. The UNCITRAL Legislative Guide notes that an exception may be required for the treatment of intellectual property licences in connection with the continuation, rejection and termination of contracts,[21] but does not treat that issue in any depth or offer any recommendations. In light of recent developments involving intellectual property in insolvencies, and the increasing importance of intellectual property as assets of insolvent enterprises, the treatment of intellectual property assets in insolvency proceedings might be examined in depth and particularized guidelines developed.

45. Intellectual property contracts are increasingly important in commercial activities and, consequently, are often integral components of the assets dealt with in an insolvency proceeding. In cases such as those involving the Nortel Networks Corporation and the Eastman Kodak Company, the intellectual property rights of the debtors constituted their largest assets. The treatment of these intellectual property rights often involves important considerations that differ from those underlying the treatment of other forms of contracts. While the rules governing the termination, continuation and assignment of ordinary contracts are often dictated by the sound business judgement of the insolvency representative, the creditors and the court, the treatment of intellectual property contracts may have wider ramifications.

46. The differing approaches to these issues were highlighted by the insolvency proceeding of Qimonda AG.[22] Qimonda is a German producer of DRAM chips for computers which operated globally and held over 12,000 patents. Qimonda had entered into numerous patent cross licensing agreements with counterparties. In January 2009, Qimonda commenced insolvency proceedings in Germany and under German insolvency law the intellectual property licences of Qimonda as licensor were terminated. Similar treatment of intellectual property licences occurs in other

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[20] This topic is proposed by the International Insolvency Institute (III).

[21] See for example, Legislative Guide, part two, chapter II, para. 115.

[22] *Re Qimonda AG Bankr. Lit.*, 433 B.R. 547; 462 B.R. 165 (2011); Clout case no. 1213.

countries, including Italy, where intellectual property licences were terminated in the insolvency proceedings concerning the company think3. When Qimonda's insolvency representative filed an application under chapter 15 of the United States Bankruptcy Code (enacting the UNCITRAL Model Law in the United States) seeking enforcement of the termination of the intellectual property licences, the United States court determined that the relief sought was "manifestly contrary" to the public policy of the United States of technological innovation and noted the "patent thicket" which permeates the semiconductor industry. This case highlights the inconsistencies between the treatment of intellectual property contracts under various regimes and creates confusion regarding the application of the UNCITRAL Model Law.

47. While termination of contracts can be advantageous for creditors of an insolvent debtor and is permitted in many countries, the termination of intellectual property contracts can have far reaching ramifications. For example, if an insolvent patent licensor terminates a patent licence for a process to make semiconductors it could bring to a halt production in a billion dollar factory of the licensee and create a worldwide shortage for manufacturers who use the product in their own devices. This cascading effect of termination has led certain countries to provide protection for the continued use of intellectual property by licensees.

48. Conversely, while an insolvent debtor is able to continue and assign intellectual property licences in some countries where the debtor is the licensee, in others the non-debtor licensor can terminate such contracts. With the increasing importance of intellectual property licences to the rehabilitation of insolvent entities, the ability of an insolvent licensee to continue, and potentially sell or assign, the intellectual property rights has become a significant factor in insolvency proceedings. Additional complications arise when the licence involves trademarks and other forms of intellectual property where the intellectual property law contemplates continuing involvement by both parties to the contract. Further complications arise when the intellectual property is linked to the performance of personal services such as exists in franchising arrangements. Policy issues such as the ability to cure non-monetary defaults and assurance of continued performance by the debtor or an assignee also require examination.

49. The work could include a comparative analysis of the treatment of intellectual property licences in insolvency proceedings in various countries and the preparation of recommendations to harmonize the treatment of parties to those licences across different regimes. Issues involving the sale, termination, continuation, rejection and assignment of intellectual property contracts could be addressed. The conclusions reached would need to be coordinated with the goals of parties to intellectual property contracts in conventional commerce. The possibility of exceptions to the general rules regarding unperformed contracts is noted in the Legislative Guide but as noted above, no recommendations regarding the treatment of intellectual property contracts were included. The growing importance of these contracts to the proper functioning of insolvency proceedings suggests the need for a thorough examination of these issues and the preparation of consistent guidelines for the treatment of intellectual property contracts. The results of this examination might take the form of a supplement to the Legislative Guide, a model law or a statement of principles and should be coordinated with the efforts of other working groups and organizations dealing with intellectual property issues.

III. Expedited, simplified proceedings, including pre-packs and other mechanisms suitable for the insolvency of micro, small and medium-sized enterprises

1. UNCITRAL references

A/CN.9/780 (Report of an UNCITRAL colloquium on microfinance held on 16-18 January 2013)

Official Records of the General Assembly, Sixty-eighth Session, Supplement No.17, (A/68/17), paragraphs 316-322 and 326

2. Background

50. UNCITRAL has conducted two colloquia in the area of microfinance and the creation of an enabling legal environment for micro, small and medium-sized enterprise (MSMEs). At its forty-sixth session (2013), the Commission considered the work undertaken on those topics and in particular the results of the colloquium held from 16-19 January 2013. The Commission agreed that work on international trade law aimed at reducing the legal obstacles faced by MSMEs throughout their life cycle and, in particular those in developing economies, should be added to its work programme. The Commission also agreed that work should start with a focus on the legal questions surrounding the simplification of incorporation and that the Secretariat should prepare documentation as a prerequisite to the early convening of the session of a working group. Working Group I, which has been given the work on that topic, will hold its first meeting from 10-14 February 2014 in New York.

51. At its forty-sixth session, the Commission also discussed issues related to the insolvency of MSMEs and requested Working Group V to conduct, at its session to be held in the first half of 2104, a preliminary examination of relevant issues, and in particular to consider whether the UNCITRAL Legislative Guide provided sufficient and adequate solutions for such enterprises. If it did not, the Working Group was requested to consider what further work and potential work product might be required, as noted above, to streamline and simplify insolvency procedures for such enterprises. Its conclusions on those issues should be included in its progress report to the Commission in 2014 in sufficient detail to enable the Commission to consider what future work might be required, if any.[1]

52. For a number of reasons, MSMEs typically face issues in the event of financial difficulty that larger enterprises do not. These reasons include:

(a) An excessive burden of risk connected to a scarcity of working capital. This situation is also connected to the decline in equity finance, increased rates of rejected applications for finance, higher interest rate spreads and larger collateral requirements;

(b) A centralized governance model in which ownership and control (often within a family) overlap. Accordingly, management is frequently unable or unwilling to approach a financial crisis in a timely manner and request the opening of insolvency proceedings. Family ownership often means that the management refuses to accept an insolvency solution that could result in their loss of control over the business. An owner will sometimes hide a crisis out of fear of damaging a good

commercial name, relationships with employees, suppliers and the market and disrupting existing lines of credit. Even in those cases where the family/individually owned MSMEs is incorporated, creditors will often be unable to see the true economic state of the enterprise. These factors may mean the crisis only becomes apparent when it is too great to hide and the enterprise has passed the point where there is no way to prevent the loss of its economic value. When small business owners look for informal solutions, they frequently lack the necessary experience to find an appropriate solution and the necessary specialized professional assistance may be too expensive;

(c) The size of the enterprise may mean that it is too small to benefit from the formal reorganization and liquidation procedures available under the insolvency law, especially where such procedures were designed for larger enterprises and are inappropriate for dealing with the essentially individual nature of many of these enterprises. At the same time, the insolvency procedures for natural persons are not designed to deal with the financial difficulties of enterprises of an industrial or commercial nature, however small. Generally these types of procedures for natural persons are established to solve problems related to consumer debt settlement and fail to take account of the commercial scope of the enterprise, which if salvaged might be able to carry on its activities to satisfy its creditors.

53. There is general agreement that an insolvency regime for MSMEs might draw from both the regimes regulating the insolvency of larger enterprises and those regulating the insolvency of natural persons. It should aim to maximize the assets and preserve the going concern of the enterprise on one hand, and provide a discharge and a fresh start on the other. At the same time, an insolvency regime for MSMEs needs to take into consideration the social and economic culture of a country, particularly with respect to the definition of MSMEs in that jurisdiction. For incorporated entities, however small, it should be possible to assure continuity. For individuals operating without the protection of incorporation (this category includes also partnerships where the partners are liable for the enterprise's debts), continuity is more difficult to achieve. However, a balance between the interests of the different stakeholders is required and punitive approaches should be avoided.

54. Experience suggests that while many insolvency laws may provide flexible and effective instruments for the survival of reversible business crises, they do not yet include procedures for smaller and micro enterprises. Insolvency laws may set arbitrary thresholds for entry into insolvency procedures by reference to, for example, amounts of debt, that will preclude the smaller enterprises. Those enterprises that are slightly larger than the thresholds may also be unable to find adequate solutions, as banks and financial institutions may be unwilling to finance their reorganization or restructuring. MSME financing may be available only when the ownership can provide sufficient collateral; for financial creditors it may be more important to recover their claims through the sale of collateral than to finance an enterprise's rescue.

55. Some States, for example Italy, have enacted laws to deal with the insolvency of natural persons that include both consumers and small enterprises. While the Italian law provides for both an agreement with creditors and for liquidation with a discharge, the complexity of the procedure, the associated costs, the conditions applying to discharge and the time required to obtain a discharge operate as disincentives to use of the law.

56. The goals of an MSME insolvency regime should include encouraging debtors to file for the opening of insolvency proceedings when necessary; incentivizing financial institutions to actively participate in the process; providing simplified procedures for reorganization and liquidation, with shorter time-frames, lighter evidentiary requirements, fewer procedural steps and, if possible, fewer appeals; and providing a discharge and a fresh start for individual entrepreneurs.