United Nations A/CN.9/WG.V/WP.55

General Assembly

Distr.: Limited
16 May 2001

Original: English

United Nations Commission on International Trade Law
Working Group on Insolvency Law
Twenty-fourth session
New York, 23 July-3 August 2001

Alternative approaches to out-of-court insolvency processes

Report of the Secretary-General

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Introduction

1. At its thirty-second session (1999), the Commission had before it a proposal by Australia (A/CN.9/462/Add.1) on possible future work in the area of insolvency law. In considering that proposal, the Commission noted that different work projects had been undertaken by other international organizations such as the International Monetary Fund, the World Bank and the International Bar Association on the development of standards and principles for insolvency regimes. Amongst the topics considered in those projects was the development, in a number of countries, of informal insolvency procedures which provide alternatives to formal insolvency procedures that offer a greater degree of flexibility and an earlier pro-active response from creditors than is normally possible under formal regimes.

2. At its twenty-second session in December 1999 the Working Group on Insolvency Law discussed issues related to informal insolvency procedures on the basis of a note by the Secretariat (A/CN.9/WG.V/WP.50, paras. 157-160) which took into account work undertaken by other international organizations on the topic.

3. The purpose of this report is to facilitate the Working Group's further consideration of informal insolvency procedures by recalling the discussions that took place at both the twenty-second session of the Working Group in December 1999 and the Global Insolvency Colloquium in December 2000, and outlining a number of proposals that have been developed to promote the use of informal processes and address some of the issues raised by their increasing use.

4. The Working Group may wish to take these developments and proposals into account in considering whether legislative action on this topic is desirable or feasible. It will be recalled that the decision of the Commission at its thirty-third session (2000) was to give the Working Group a mandate that included consideration of out-of-court reorganization as one of the core features of a strong insolvency, debtor-creditor regime. If the Working Group is of the view that legislative work should be undertaken, it may wish to consider whether that work should be prepared as an integral part of the draft legislative guide, which is essentially aimed at formal insolvency proceedings, or whether it could be developed in parallel with the guide, but as a separate, related project, on the basis that the topic raises different issues and concerns and is not as widely understood or practised as formal procedures.

5. Informal out-of-court proceedings are often referred to by a number of different terms, including "restructuring", "rescue", "reorganisation", "reconstruction" and "workout", sometimes in combination with the word "voluntary". To distinguish these informal, voluntary proceedings from the formal proceedings discussed in document A/CN.9/WG.V/WP.54 and Adds.1 and 2, the processes discussed in this paper are referred to, where possible, as "out-of-court procedures". Where the reports of other organizations are referred to, the terminology used in those reports is maintained, so that a number of different terms may appear in this document.

1. Asian Development Bank Report

6. The issues associated with informal insolvency procedures were considered in a Report by the Asian Development Bank (the ADB Report)[1] (pp. 25-27) which describes the necessary conditions for informal procedures, as well as the main processes and practical problems. It notes (p. 63) that, since the commercial culture of many of the countries studied for the Report are conditioned toward non-confrontational dispute resolution, there may be a relatively firm basis upon which to promote and build the elements necessary to structure an informal negotiated approach to the problems of insolvent or financially troubled debtors. The following material, which is extracted from document A/CN.9/WG.V/WP.50, paras. 158-160, was considered by the Working Group on Insolvency Law at its twenty-second session (December 1999):

> "158. The ADB Report (p. 24) points to a number of well-defined initial premises that are required for informal processes to be effective. These include: significant debts owed to a number of different creditors, usually banks or other financial institutions; a preference for negotiating an arrangement for the financial difficulties of the debtor; availability of relatively sophisticated refinancing, security and other commercial techniques that can be used to rearrange or restructure the debts; the sanction of resort to insolvency law if the informal process breaks down; and the prospect of greater benefit for all through negotiation rather than formal processes.
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> "159. The process of what the ADB terms "informal workout" includes a number of steps: creation of a forum in which debtor and creditors can explore and negotiate an arrangement to deal with the debtor's financial difficulties; appointment of a "lead" bank creditor to organize and manage the process; establishment of a "steering" committee of creditors; an agreement to suspend adverse actions by both creditors and the debtor which may be compared to the stay of actions and proceedings in formal proceedings; and the provision of information on the debtor's situation, including its activities, current trading position and so on.
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> "160. The ADB Report raises (pp. 25-27) a number of issues that may need to be resolved in developing an informal process. These include: identifying which party may initiate the process and the tools that may be used to ensure the progress of that process; the extent to which independent experts and advisors should be involved in the process; the means of resolving differences between creditors, particularly with respect to competing priority rights; dealing with dissenting creditors and creditors that it may not be possible to actively engage in the process because of their sheer number; the provision of ongoing funding to the debtor entity; and the establishment of priorities to secure that funding."

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[1] Asian Development Bank, Regional Technical Assistance Project, TA No: 5795-REG, Insolvency Law Reform: Preliminary Comparative Report, 1999 ("the ADB Report"); also Special Report: Insolvency Law Reform in the Asian and Pacific Region, Law and Development at the Asian Development Bank, 1999 ed.

2. UNCITRAL Working Group on Insolvency Law

7. The following paragraphs are extracted from the Report of the twenty-second session (December 1999) of the Working Group (document A/CN.9/469, paras. 105-112 and 116-121):

> "105. At various stages of the discussion on informal insolvency procedures references were made to the fact that frequently an insolvent debtor and its creditors engaged in out-of-court collective negotiations with a view to finding an agreed solution to the debtor's financial difficulties. It was noted that such negotiations (which might include, e.g. fresh financing and reorganisation of the debtor's operations), in order to be successful, had to include all creditors or at least creditors representing the critical part of the debtor's total obligations.
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> "106. It was noted that such voluntary out-of-court arrangements were often the lowest-cost way of resolving an insolvent company's financial difficulties. They provided an important opportunity to preserve the ongoing business enterprise, preserve employment and, by preserving the going-concern value of the business, frequently maximized the value available to all interested parties. Out-of-court procedures also avoided many of the costs, delays and difficult distributional issues faced in the context of plenary, court supervised, insolvency proceedings.
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> "107. It was further observed that fast growing companies in developing economies often had numerous lenders based in different countries. When those companies encountered financial troubles, it was often difficult for them to organize a productive out-of-court resolution with their multinational creditors from diverse commercial cultures. Voluntary arrangements were also impeded by the ability of individual creditors to take enforcement action and by the need for unanimous creditor consent to alter the repayment terms of existing classes of debt. In the context of complex international transactions it was especially difficult to obtain agreement from all the relevant parties. For those reasons, it was stated, existing non-binding measures designed to facilitate voluntary arrangements had been implemented with only limited success.
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> "108. It was suggested that, in light of those considerations, an internationally developed mechanism for binding creditors could assist greatly in facilitating out-of-court arrangements. The view was expressed that the Commission could be instrumental in developing a legal mechanism that could be used in connection with voluntary arrangements. It was proposed that discussion might be confined to major cross-border insolvency situations and to financial indebtedness (i.e., banking and other financial loans), thus leaving aside creditors such as suppliers of goods or services and employees. The purpose of such a mechanism to be elaborated might be to set out conditions under which a solution agreed upon by a majority might be imposed on the minority, to provide for a stay of actions and executions by the creditor group covered, and to ensure that the minority group was treated fairly.
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> "109. However, it was observed that financial loans were sometimes extended through banks in the debtor's country and that, therefore, the proposed mechanism should cover major financial indebtedness insolvency situations even if the creditors were from the same country as the debtor.
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> "110. Comments were made that the strongest incentive to engage in such out-of-court negotiations was the imminence, effectiveness and credibility of proceedings

to enforce private claims and securities and of involuntary, formal, court supervised insolvency proceedings and the desire of both debtor and creditors to avoid the disruptive and stringent consequences of those proceedings. When such court proceedings were not credible or effective (e.g. because of court delays or because they did not ensure equitable treatment of creditors), the debtor might not be willing to engage in out-of-court negotiations. Even the prospect of fresh financing linked to an informally negotiated solution might not be sufficient incentive for the debtor inasmuch as ineffective court proceedings allowed the debtor to delay having to meet its obligations. Furthermore, experience had shown that leverage was needed over some creditors who might hold out for full satisfaction of their claims.

"111. Reservations were expressed regarding the proposition of elaborating a mandatory legislative mechanism designed to promote out-of-court procedures. It was said that the informal process of out-of-court negotiations might be disturbed by the formality of the proposed mechanism. It was also said that the proposal was likely to encounter opposition, in particular in the banking community, and that therefore any further work should be preceded by consultations with the banking community. Furthermore, any such legislative concept might have to be tailored to conditions in various regions and, therefore, universal solutions were difficult to obtain. It was suggested that, to the extent formality was desirable, an institution instigating and promoting out-of-court procedures could be useful, but such institutional arrangements did not lend themselves to internationally harmonized solutions. Concerns were also expressed about whether the court was an appropriate body to give rulings on what were essentially matters of business judgment.

"112. However, opinions were also expressed that, while realizing potential difficulties and pitfalls involved in a mandatory legislative framework for out-of-court procedures, the proposal should not be abandoned because a well thought out mechanism might offer significant benefits. It was added that if the role of the court in informal negotiations was limited to the approval of the fairness of the outcome, that might be widely acceptable and would not be overly intrusive. As an alternative, it was envisaged that the out-of-court procedure might include a non-judicial forum that would be empowered, by agreement of the parties, to evaluate whether the arrangement negotiated between the debtor and the majority of creditors was fair and, if it was found to be fair, to bind the minority of non-consenting creditors.

"116. In response to questions, it was suggested that the debtor and creditors would join out-of-court negotiations out of their own interest or pursuant to their contractual obligations, and that any legislative mechanism to be prepared should not establish a statutory duty for the debtor or creditors to participate in the negotiations.

"117. In response to a further question as to why the process was limited to financial creditors and did not include creditors who had supplied goods or services to the debtor, statements were made to the effect that experience showed that financial creditors often shared the same or similar interests and therefore more easily organized themselves for negotiations with the debtor, which was not the case with trade creditors. Furthermore, the focus and goal of the out-of-court procedure was typically the reorganisation of the capital structure of the debtor and the provision of fresh financing, which was more easily addressed by providers of finance than by trade creditors. Moreover, the terms of agreement reached with the

debtor often allowed trade creditors to 'ride out' the debtor's crisis and be paid in full or make a smaller sacrifice than the providers of finance.

"118. Several cautionary opinions and reservations were expressed about the proposed work. They included the following: there was a danger that large and influential creditors might use the mechanism to impose their views without taking due account of the interests of small or dissenting creditors; the proposed process lacked transparency, which was potentially troublesome in view of the fact that the result was to be binding on the dissenting creditors; the envisaged mechanism should only be allowed to operate to the extent the negotiations were not covered by the laws and regulations in the debtor's country or by international treaties; it was essential that the envisaged mechanism should ultimately be subject to court control; the mechanism, in particular if it involved a non-judicial forum such as arbitration, was likely to be costlier than the mechanism involving court supervision and that the negotiations might take place at a place distant from the debtor's place of business, which might, for that reason, impose a substantial burden on the debtor and some creditors. In response, it was stated that experience with out-of-court procedures showed that they were less costly and more efficient than court supervised insolvency proceedings.

"119. It was considered that it was necessary to elaborate substantive criteria and rules under which minority creditors could be bound by an arrangement negotiated by the majority of creditors and that proper balance had to be found between the need to maintain confidentiality of certain types of information divulged during negotiations and the need for transparency of the process.

"120. Statements were made, and the Working Group agreed, that much of the expertise and experience regarding out-of-court procedures rested in organizations such as the International Monetary Fund, the World Bank, The Group of Thirty, INSOL International and the International Bar Association and that any work in the Commission should be carried out in close cooperation with those organizations and with the financial sector.

"121. After discussion, it was found that there was sufficient support in the Working Group for proposing to the Commission that it include in its agenda out-of-court arrangements between financial creditors and the debtor that included also the possibility of binding dissenting creditors."

8. The proposal of the Working Group was agreed to by the Commission at its thirty-third session (2000).

3. Joint UNCITRAL/INSOL/IBA Global Insolvency Colloquium

9. At the jointly sponsored UNCITRAL/INSOL/IBA Global Insolvency Colloquium in Vienna in December 2000, the issue of out-of-court procedures was further discussed as an element identified (along with 13 other key topics relating to liquidation and reorganization) as a topic for possible consideration by UNCITRAL in its draft legislative guide. The following paragraphs summarise the discussion that took place (document A/CN.9/495, paras. 27-28):

"27. It appeared to participants that it would be advantageous to have a system which encouraged the parties to avoid the delay of a formal court proceeding over

> an extended period of time, which provided alternative processes to assist in and facilitate the rescue of capital at an early stage, and which might be more cost effective than formal proceedings. It was suggested that while such a system worked best where there was a functional law and infrastructure that could ensure certainty of outcome, it was also useful where the institutional framework was not effective."

10. Work by the INSOL Lenders Group on the "Statement of Principles for a global approach to multi-creditor workouts" was introduced (the Principles are discussed in more detail below). The Principles were formulated with a broad base of participation from over 150 institutions, including banking institutions, insurance companies, institutional investors, investment bankers, insolvency and finance professionals, Government representatives, and regulatory authorities in many countries. The development of the Principles was in recognition of the increasingly widespread use of informal insolvency processes and the growing difficulties associated with bringing them to a successful conclusion. The Principles are designed to expedite those processes, and therefore increase the prospects for success, by providing guidance to diverse creditor groups about how to proceed on the basis of some common agreed rules. They have the potential to make the process quicker; to reduce uncertainty, time, cost, and inter-creditor tension and distrust; thereby helping preserve the value of the business by turning attention more quickly to the issues of preserving economic value.

11. The Principles point out that although there has been a growing international trend in the development of local insolvency laws to facilitate the rescue and rehabilitation of companies and businesses in financial difficulty, it is a truism that, no matter how debtor-friendly and "rescue"-oriented local insolvency regimes may be, there are often material advantages for both creditors and debtors in the expeditious implementation of informal or contract-based rescues or workouts compared with the unpredictable costs and uncertainties of a formal insolvency.

12. The Principles are not intended to be binding and it is emphasized that they are most likely to facilitate workouts where there is an appropriate legal, regulatory and governmental policy framework for insolvency that is effective, predictable and reliable; the Principles would operate in what is described as the "shadow of the law". The existence and prospective implementation on a consistent basis of a well-designed insolvency law, by providing financial creditors with effective means of recourse against uncooperative debtors, encourages debtors to co-operate with those creditors with a view to negotiating an agreement outside a formal insolvency in an acceptable timeframe.

> "28. …The formulation of the Principles was welcomed by participants at the Colloquium. There were suggestions, however, that the Principles might not go far enough and that something more might be required to ensure that agreements reached out-of-court were implemented. A further proposal was made to have introduced into the insolvency system an accelerated procedure to implement a restructuring plan that was not fully consensual, but that was endorsed by the vast majority ofcreditors. The plan would be processed through a court (being a court administering insolvency cases) with a view to binding the dissenting minority, provided that it met certain objective criteria specified in the insolvency law. It was widely felt by participants that in-depth analysis would be required in order to decide whether such a proposal should be pursued within the scope of the work on insolvency that the Commission might undertake." The proposal is set forth in more detail below.

4. INSOL Lender's Group Statement of Principles for a global approach to multi-creditor workouts

13. The Principles were completed by the INSOL Lender's Group in 2000. The Principles are accompanied by a commentary, which explains the scope and application of each principle, as well as indicating best practice and offering suggestions on a number of issues not specifically addressed in the Principles themselves. As noted above in para. 12, the Principles are intended to operate against the backdrop of an effective, predictable and reliable insolvency system. The eight Principles are set forth below and are accompanied by a summary of the commentary prepared by the Secretariat.

First Principle

> **Where a debtor is found to be in financial difficulties, all relevant creditors should be prepared to co-operate with each other to give sufficient (though limited) time (a "Standstill Period") to the debtor for information about the debtor to be obtained and evaluated and for proposals for resolving the debtor's financial difficulties to be formulated and assessed, unless such a course is inappropriate in a particular case.**

14. The commentary indicates that this Principle is intended to ensure that all creditors whose co-operation is needed in order to make any attempted rescue or workout succeed are included within the informal process, requiring firstly, the identification of those classes of creditors that need to be included and secondly, which creditors in the affected classes are to be included. The establishment of a Standstill Period recognises the benefits to be derived for creditors as a whole from a co-ordinated and measured response to the debtor in difficulty. Although not specified in the Principle, the commentary addresses the commencement of the Standstill Period noting that whilst this is a problematic area, it is quite common for the relevant creditors to choose the date on which the financial creditors as a group (or at least some significant group or class of their number) were first notified by the debtor or by another financial creditor of a meeting called to allow the debtor to explain its position to the relevant creditors. The commentary notes that while the duration of the Standstill Period will vary from case to case, depending upon complexity of the information to be gathered and the nature of any restructuring proposal, it is customarily applied for an initial period of weeks or months, usually with a capacity for extension if all relevant creditors agree, or for termination if a predetermined number elect to do so following agreed events of default or at their discretion.

Second Principle

> **During the Standstill Period, all relevant creditors should agree to refrain from taking any steps to enforce their claims against or (otherwise than by disposal of their debt to a third party) to reduce their exposure to the debtor but are entitled to expect that during the Standstill Period their position relative to other creditors and each other will not be prejudiced.**

15. The commentary underlines the importance of the stay to ensure stability, an essential backdrop to any attempted rescue or workout. Whilst noting that some jurisdictions do provide for statutory pre-insolvency stay of creditor claims, there is often advantage to both creditors and the debtor in adopting an informal or contract-based approach to avoid the costs associated with the formal approach. It outlines the issues that such a standstill agreement should address, including provisions which are designed to

ensure that the position of relevant creditors does not deteriorate vis-à-vis each other during the Standstill Period. More sophisticated standstill agreements include provisions addressing the more difficult issue of maintaining the position of creditors relevant to each other.

Third Principle

> **During the Standstill Period, the debtor should not take any action which might adversely affect the prospective return to relevant creditors (either collectively or individually) as compared with the position at the Standstill Commencement Date.**

16. The commentary notes the importance of the debtor refraining from such actions and cites a number of examples of prejudicial actions which might include: offering security in the form of charges, mortgages, liens, guarantees or indemnities to non-participating creditors; transferring assets or value away from the companies to which participating creditors have recourse; selling assets to third parties at an undervalue or to creditors who, because they are already owed money, will not pay for them.

Fourth Principle

> **The interests of relevant creditors are best served by co-ordinating their response to a debtor in financial difficulty. Such co-ordination will be facilitated by the selection of one or more representative co-ordination committees and by the appointment of professional advisers to advise and assist such committees and, where appropriate, the relevant creditors participating in the process as a whole.**

17. The commentary outlines the advantages to be gained from the use of co-ordination committees and a number of the issues to be addressed where they are used including the ways in which such committees might be formed and operate, the powers of co-ordinators and recompense for discharging their role, as well as their liability to creditors and how co-ordinators should be selected.

Fifth Principle

> **During the Standstill Period, the debtor should provide, and allow relevant creditors and/or their professional advisers reasonable and timely access to, all relevant information relating to its assets, liabilities, business and prospects, in order to enable proper evaluation to be made of its financial position and any proposals to be made to relevant creditors.**

18. The commentary underlines the importance of this Principle to the success of rescue, workout or reconstruction. It points out that the information must be obtained, or at least capable of due diligence, by independent advisors acting for relevant creditors and the need for the debtor to accept that the advisers to the relevant creditors will be expected to review the accuracy of accounts, projections, forecasts and business plans related to any proposals for rescue or reconstruction. They will also need to estimate the consequences of the relevant creditors refusing to agree to the proposals being put to them.

Sixth Principle

Proposals for resolving the financial difficulties of the debtor and, so far as is practicable, arrangements between relevant creditors relating to any standstill should reflect applicable law and the relative positions of relevant creditors at the Standstill Commencement Date.

19. Having evaluated the debtor's position and satisfied themselves that they are receiving equitable treatment relative to other creditors, relevant creditors will wish to compare what may be offered to them with what they might expect from a formal insolvency or from other options open to them. In making such assessments, it is not uncommon for accountants and other financial advisers acting for relevant creditors to base their advice on insolvency models produced in respect of the debtor which operate by reference to certain stated accounting and legal assumptions and are based on the information produced through the due diligence process (Principle 5). The models should take account of all relevant claims and entitlements which would be counted in any insolvency of the debtor and of all relevant insolvency laws. The output from the insolvency models can be used to identify the claims that relevant creditors may have against the debtor; to estimate the likely return to such creditors from their claims and to estimate the proportion of the indebtedness due to relevant creditors which appears to be covered by assets.

Seventh Principle

Information obtained for the purposes of the process concerning the assets, liabilities and business of the debtor and any proposals for resolving its difficulties should be made available to all relevant creditors and should, unless already publicly available, to be treated as confidential.

20. The commentary to this Principle notes that it is essential that all relevant creditors are provided with the same information regarding the assets, liabilities and business of the debtor during the informal process and that they all see the proposals put forward by the debtor. It notes that this should be the case even where differing proposals are being put to differing constituencies within the relevant creditor group as a whole and even if differences in the position between the relevant creditors mean that separate professional advice is required for separate constituencies. It is noted that the holding of confidential information by some groups of creditors, such as banks, is generally not problematic. The commentary points to other groups, however, such as holders of debt which either are not subject to express or implied duties of confidence or cannot accept confidential information without prejudice to their ability to trade debt, where special arrangements may need to be made. It addresses debt trading as a mechanism which is increasingly favoured by financial institutions for managing credit exposures and realising values associated with their lending and notes some of the sensitivities that may arise with respect to protection of confidential information.

Eighth Principle

If additional funding is provided during the Standstill Period or under any rescue or restructuring proposals, the repayment of such additional funding should, so far as possible, be accorded priority status as compared to other indebtedness or claims of relevant creditors.

21. The commentary addresses the means of securing the availability of additional funding and notes that it might involve not only additional loan facilities, but also other

forms of increase in exposure levels. Treatment of these other forms will be a matter of negotiation among relevant creditors. It is suggested that all relevant creditors participating in the process should be given the opportunity to participate in the provision of additional funding, and should accept the risks associated with the provision of additional funding on a proportionate basis.

5. Proposal for implementing restructurings through the use of court supervised insolvency proceedings

22. Several members of the United States of America's delegation to the UNCITRAL Working Group on Insolvency Law have developed a proposal for a statutory framework that would provide for expedited insolvency proceedings to implement a voluntary restructuring of borrowed money indebtedness (institutional lender debt and bonds) of insolvent international business enterprises based upon approval of the restructuring by a requisite supermajority of each affected class, and judicial review of the adequacy of the restructuring assessed against appropriate international restructuring standards.

23. The principle features of the proposal include: the ability to declare a brief moratorium to permit voluntary restructuring discussions to be completed; solicitation of creditor approvals for a restructuring before the commencement of legal proceedings; an approval requirement of 75% in number and value of affected classes of creditors; expedited insolvency procedures for approval of the restructuring by an insolvency court to make it binding on dissenting creditors; and minimum legal criteria for court approval of the restructuring.

24. The proposal is set forth below.

"*(a) Eligible debtors*

1. The procedures under the model statute would be available to any insolvent or defaulting business enterprise with substantial borrowings from foreign persons. Criteria addressing size, for proving insolvency/default status and for establishing that sufficient amounts of debt are held by foreigners would be established. Certain types of regulated debtors, such as financial institutions and insurance companies, might be excluded from the application of the law.

"*(b) Parties affected*

2. Under the model statute, restructuring would have to be approved by a supermajority vote of each affected class of claimants. However, only borrowed money indebtedness (institutional and public, whether secured or unsecured) and other similar financial obligations could be adjusted by such a vote. Indebtedness held by other creditors would not be affected unless they individually agreed to adjustment of their claims. Indebtedness such as that of trade creditors, employees and taxing authorities would not be affected by the proposal. Common stockholders and other equity holders could, however, be covered.

"*(c) Stay*

3. In many instances, restructuring can be accomplished, even after default, because of the voluntary agreement of creditors to delay collection actions. In order to facilitate restructuring efforts, however, the proposed statute might include an appropriately limited statutory stay on such actions to ensure that restructuring

efforts would not be thwarted by creditor action. In connection with a bona fide restructuring proposal, an eligible company could declare a brief temporary stay that would suspend collection activities by affected classes, that is lenders, bondholders and shareholders but not vendors or employees. Public notice of that declaration would be given by, for example, filing the declaration in the appropriate court, publication or other appropriate means, specifying whether all, or only certain, creditors and shareholders are subject to the stay.

4. The initial period of application of the stay would be relatively short (e.g., 15 days), but might be subject to extension with the consent of holders of a material portion of creditors in affected classes (e.g., a further 30-60 days with the written approval of a majority in principal amount of each affected class of unsecured creditors). In addition, the stay could be designed to terminate if the debtor sought to effect transactions (e.g., terminate its business or engage in substantial asset transfers) outside the ordinary course of business or sought, outside of an approved restructuring, to afford preferential treatment to a subset of creditors.

"*(d) Acceptance of the negotiated restructuring proposal*

5. After proposal of a restructuring and informal negotiations with representatives of affected creditors and shareholders, the enterprise would solicit acceptances of the negotiated restructuring proposal from affected creditors and equity security holders in accordance with otherwise applicable law.

"*(e) Requisite vote*

6. Claims and interests would have to be appropriately classified for voting purposes, and the affirmative vote of the requisite statutory majorities in amount and number of claims of each class for approval of the restructuring would need to be obtained. Under the proposed statute, a substantial supermajority vote of each affected class (e.g. 75% in number and value of those voting in each class) would be required for approval of a restructuring.

"*(f) Judicial determination of adequacy of restructuring under international criteria*

7. Because the dissenting minority of creditors in each class would be bound by a restructuring under the model statute, judicial determination, applying appropriate international restructuring criteria, should be made as to the adequacy of the restructuring to the dissenting minority of creditors. The effectiveness of a restructuring would be conditioned upon that judicial determination of adequacy. An independent expert could be retained by the debtor company to facilitate judicial review. Eligibility criteria for selection of the independent expert might be specified in the statute. The expert, who would be compensated by the debtor company, would review the restructuring proposal, make findings as to satisfaction, or otherwise, of the international restructuring criteria and issue a report containing such findings. The proposal, together with the expert's report, would then be submitted for approval by an appropriate local court.

"*(g) Notice and criteria for approval*

8. Affected parties should be notified of completion of the solicitation procedures and submission of the restructuring for review by the independent expert and final court approval. Expedited procedures for submissions to the

independent expert in support of, and in opposition to, the restructuring would also be envisaged. Copies of these submissions would be filed with the Court and a deadline for submissions (e.g., 20 days after publication of notice) and perhaps also for a qualifying report (e.g., 30 days after completion of submissions to the independent expert) might need to be specified.

9. Upon completion of the independent expert's report, proceedings would be commenced in an appropriate local court (the court) to obtain approval of the restructuring. In order to approve a restructuring over the vote of dissenting creditors in each affected class, the court would be required to make certain findings of fact and law to establish the adequacy of the restructuring under appropriate international restructuring criteria. In making its determination, the court would be expected to give substantial weight to the independent report. The international restructuring criteria might require the court to conclude, for example, that:

(i) the company is eligible to implement a restructuring under the model statute;

(ii) the restructuring was proposed, negotiated and solicited in good faith;

(iii) disclosure to each affected class of creditors was adequate;

(iv) creditors and shareholders in affected classes were properly classified, and the requisite supermajorities of each affected class of creditors have agreed to the restructuring;

(v) claims in affected classes having the same status and priority are receiving comparable treatment in connection with the restructuring (except to the extent they have expressly agreed otherwise);

(vi) each non-assenting creditor in an affected class will receive, in the restructuring, property having a value at least equal to what it would receive if the company were liquidated in formal insolvency proceedings under local law;

(vii) after effectuating the restructuring, the company is likely to meet its obligations when due; and

(viii) in the event that any class of affected equity holders fails to accept the plan, the aggregate indebtedness of the company exceeds the (debt free) value of its business as a going concern (i.e., the enterprise is insolvent).

"*(h) Declaration of effectiveness*

10. Where restructuring is approved by the court and all conditions for effectiveness of the restructuring are satisfied, notice to affected creditors would be published in accordance with specified procedures, and the court would issue a "Declaration of Effectiveness" (to be given the effect of a binding judicial decree) to the effect that the restructuring was effective under the statute.

"*(i) Discharge and enforceability*

11. The Declaration of Effectiveness would discharge any indebtedness extinguished under the terms of the restructuring, and local courts would be bound to enforce the restructuring in accordance with its terms.

"*(j) Alternatives to judicial approval*

12. While the judicial systems of some States may afford the type of cost effective expedited review of restructuring proposals required under the model statute, there may be States in which it would be desirable to avoid more cumbersome judicial processes to enhance the potential for successful rescue, to preserve value, to prevent the loss of employment and production, and to lessen the systemic impact of failing enterprises. Options could be considered, drawing upon established practices and structures, to validate restructurings utilizing non-judicial methods - approval procedures that foster expeditious and equitable voluntary out-of-court restructurings are critical to upgrading country risk factors and lessening systemic financial risk, as well as to facilitating both investment and the restructuring of invested capital when that is required.

"*(k) Effect on national law*

13. National laws which require unanimous agreement to adjust indebtedness outside of insolvency would have to be modified to permit adjustments of indebtedness in restructurings approved in accordance with the proposed model statute. Similarly, where national laws provide that directors or officers of a business enterprise may be liable for trading while insolvent, modification may be needed to provide for some form of relief, after appropriate disclosure, to allow ongoing trading while bona fide efforts to restructure under the model statute are under way.

"*(l) International recognition*

14. In order to enhance the likelihood that the restructuring under a home country's model statute will be honoured by courts both at home and abroad, commercial parties could be encouraged to adopt a practice of expressly incorporating application of the model statute into the terms of their debt obligations. The model statute could also provide that the right to restructure indebtedness after insolvency under the model statute is an implied term of each obligation incurred by a local debtor unless expressly disclaimed.

15. To the extent that issues relating to the binding effect or enforceability of a restructuring under the model statute arise in courts of another jurisdiction, those issues should be addressed consistent with the notions of co-ordination and co-operation in UNCITRAL's Model Law on Cross-Border Insolvency. To facilitate this, it may be desirable to provide for a procedure whereby a debtor restructured under the model statute can obtain the appointment of a representative who would be recognized as a foreign representative in other States for purposes of seeking enforcement of the terms of the restructuring.

16. Finally, the model statute could also contain provisions granting recognition in national courts to restructuring of foreign debtors accomplished under the model statute as enacted in other States."

6. World Bank

25. The recently completed report by the World Bank "Principles and guidelines for effective insolvency and creditor rights systems" includes a discussion of informal out-of-court processes in Principles 25 and 26 which provide:

> **Principle 25: Enabling legislative framework.** *Corporate workouts and restructurings should be supported by an enabling environment that encourages participants to engage in consensual arrangements designed to restore an enterprise to financial viability. An enabling environment includes laws and procedures that require disclosure of or ensure access to timely, reliable and accurate financial information on the distressed enterprise; encourage lending to, investment in or recapitalization of viable financially distressed enterprises; support a broad range of restructuring activities, such as debt writeoffs, reschedulings, restructuring and debt- equity conversions; and provide favourable or neutral tax treatment for restructuring*.
>
> **Principle 26: Informal workout procedures.** *A country's financial sector (possibly with the informal endorsement and assistance of the central bank or finance ministry) should promote the development of a code of conduct on an informal out-of-court process for dealing with cases of corporate financial difficulty in which banks and other financial institutions have a significant exposure—especially in markets where enterprise insolvency has reached systemic levels. An informal process is far more likely to be sustained where there are adequate creditor remedy and insolvency laws. The informal process may produce a formal rescue, which should be able to quickly process a packaged plan produced by the informal process. The formal process may work better if it enables creditors and debtors to use informal techniques*.

26. Many of the issues considered above are raised in the discussion of these two Principles in the Report. The Report notes, in respect of Principle 26, the development of the INSOL Principles, and the background to the increasing use of informal out-of-court processes. In addition to the well-defined initial premises identified in the ADB Report as necessary pre-conditions for an effective informal process (see para. 6 above), the World Bank Principles add a further one: that the debtor does not require relief from trade debt, or the benefits of formal insolvency, such as the automatic stay or the ability to reject burdensome contracts and the existence of favourable or neutral tax treatment for restructuring both in the debtor's jurisdiction and the jurisdictions of foreign creditors. The Principles emphasize the primary importance of the presence of the sanction, that is the ability to resort to formal processes should the informal processes break down.