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Alternative informal insolvency processes

Comments by the Commercial Finance Association

1. On 19 October 2001 the Secretariat received comments by the Commercial Finance Association on informal insolvency processes. The text of those comments is reproduced in the annex to this note in the form in which it was received by the Secretariat.

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Annex

Informal Insolvency Procedures

A. Introduction

Commercial Finance Association ("CFA") is pleased to submit this Memorandum to the UNCITRAL Working Group on Insolvency Law (the “Working Group”) in connection with its consideration of the desirability and feasibility of legislation concerning informal insolvency procedures ("Procedures"). This Memorandum is in response to the Report of the Secretary-General of UNCITRAL on alternative approaches to out-of-court insolvency processes (A/CN.9/WG.V.WP.55) (the "Report").

By way of background, CFA is a trade association for financial institutions that provide asset-based commercial financing and factoring to business borrowers. Although most of the members of CFA are headquartered in North America, many are located, or have affiliates or branches, outside North America, or are owned by entities headquartered outside North America. Among the nearly 300 members of CFA are substantially all of the major money center and important regional banks and other large and small commercial lenders in North America. CFA members provide financing to businesses on an international, national, regional and local scale. Most of the borrowers served by CFA members depend upon secured financing to operate and grow. Although much of this financing is used by businesses for working capital purposes, a substantial amount of it is used to finance the acquisition of other companies. Financing provided by CFA members is generally secured by various forms of personal and real property collateral owned by borrowers or guarantors, including accounts receivable, inventory, equipment, real estate, intellectual property and investment securities. Last year, secured financing provided by CFA members totaled in excess of USD 340 billion.

In recent years, CFA members have become increasingly active in making cross-border loans, including loans predicated on the value of collateral located in other jurisdictions and denominated in local currencies. This increased activity in cross-border lending flows naturally from the increased globalization of borrowers, fueled by reductions in trade barriers and explosive developments in technology.

B. Discussion

As a general matter, CFA believes that the development of Procedures may be desirable as a means of promoting the availability of lower cost credit in states that adopt such Procedures. In CFA's view, the central theme of any set of Procedures should be to provide a mechanism for implementing, in an efficient and cost-effective manner, an agreement on restructuring the debts of a debtor company (a "Borrower") that is endorsed by all or substantially all of the Borrower's creditors (other than trade creditors), without the cost and delay inherent in typical formal insolvency proceedings.

If a primary purpose of the Procedures is to promote the availability of secured credit, CFA submits that the Procedures should not create circumstances in which a secured lender is worse off under the Procedures than it would be under applicable formal insolvency laws. Thus, CFA suggests that the Procedures should not, without the secured lender's consent, impair either the secured lender's rights and remedies in its collateral or the value of the collateral. Thus, for example, the Procedures should preserve the secured

lender's rights in (i) proceeds of its collateral and (ii) after-acquired property, and should not require the secured lender to release or exchange collateral without appropriate substitute collateral. Further, if any of the secured lender's collateral is used during the restructuring process, the Procedures should provide for reasonable compensation to the secured lender for any diminution in the value of the collateral resulting from such use. Moreover, the Procedures should not, without the secured lender's consent, frustrate the reasonable expectations of the secured lender under its loan documents with respect to choice of law or applicable forum.

In order to be effective, CFA believes that the Procedures should empower the insolvency court to (i) temporarily stay actions by creditors against the Borrower and its property, (ii) bind dissenting creditors to the restructuring plan, and (iii) prevent the Borrower from withdrawing from a restructuring plan to which it has previously agreed. This suggests that the Procedures take the form of legislation (ideally as part of the formal insolvency laws rather than separate legislation), as opposed to a set of core principles.

Further, in order to promote the use of the Procedures in a given jurisdiction, the insolvency court should be authorized to defer to pending restructuring negotiations being conducted in accordance with the Procedures if the court determines that the negotiations have a realistic prospect of success and the proposed restructuring is in the best interests of the creditors generally. The Procedures should also incorporate an expedited means of obtaining judicial review and approval of the proposed restructuring.

CFA also believes that the Procedures should incorporate a mechanism for financing the operations of the Borrower during the restructuring negotiations, with appropriate priority and other protections being afforded to the parties providing such financing. However, such financing should not prejudice the rights of existing secured lenders electing not to provide such financing ("Non-electing Lenders"). Thus, CFA suggests that (i) no lien superior to those of the Non-electing Lenders should be granted without the consent of the Non-electing Lenders, unless the Non-electing Lenders already have, or are provided with, collateral having a value substantially in excess of the indebtedness owing to them and (ii) no lien junior to the liens held by the Non-electing Lenders should be granted without subordination and standstill provisions reasonably acceptable to the Non-electing Lenders.

A secured lender that elects to withdraw from the restructuring process should be permitted to do so on an expedited basis (thereby obtaining judicial relief from any stay) upon a showing that it is prejudiced by the proposed restructuring. Such expedited relief should be available even if such secured lender's collateral is essential to the restructuring. Such relief should be available in any forum that would have been available to the secured lender under its loan documents and otherwise applicable law.

C. Conclusion

CFA believes that the development of Procedures consistent with the foregoing principles would encourage secured lenders to extend financing in jurisdictions adopting such Procedures. On the other hand, CFA also believes that Procedures which do not recognize such principles would have a deterrent effect on secured lending to the extent they frustrate the reasonable expectations of secured lenders concerning the enforcement of their rights and remedies under applicable formal insolvency laws and other creditors' rights laws.