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Draft legislative guide on insolvency law

Note by the Secretariat

Contents

[The Introduction and Part One of the draft Guide appear in document A/CN.9/WG.V/WP.63; Part Two, Chapter I appears in documents A/CN.9/WG.V/WP.63/Add.1 and Add.2; Chapter II.A and B appear in documents A/CN.9/WG.V/WP.63/Adds.3-4; Chapter III.A-F appear in documents A/CN.9/WG.V/WP.63/Adds.5-9; Chapter IV.A-D appear in documents A/CN.9/WG.V/WP.63/Adds.10-11; and Chapters VI-VII appear in subsequent addenda]

* This document was submitted late because of the need to complete consultations and finalize consequent amendments.

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Paragraph numbers in [..] refer to relevant paragraph numbers in A/CN.9/WG.V/WP.58, the previous version of the text of the Guide.
Recommendation numbers in [..] refer to relevant recommendations in A/CN.9/WG.V/WP.61 and A/CN.9/WG.V/WP.61/Add.1, the previous version of the recommendations. Additions to the recommendations are indicated in this document by underlined text.

Part Two (continued)

V. Reorganization

A. The reorganization plan

1. Introduction

304. [261] Insolvency laws generally address a number of issues in relation to the reorganization plan, such as the nature or form of the plan; when the plan is to be prepared; who is able to prepare the plan; what is to be included in the plan; how the plan is to be approved and the effect of the plan.

305. [262] Reorganization plans perform different functions in different types of proceedings. In some, the plan may be the tailpiece of the reorganization proceedings, dealing with the pay-out of a dividend in full and final settlement of all claims (also referred to as a composition or a scheme of arrangement) and the final structure of the business after the reorganization is complete or it may be proposed at the commencement of the proceedings and set out the way the debtor and the business should be dealt with during the reorganization period, much like a business plan, as well as expected dividends and dates of payment. There may also be circumstances where a plan, like a plan of reorganization, is prepared in liquidation where the business is to be sold as a going concern and may address the timing and mechanics for interim distributions. The following discussion focuses upon the issues that would be relevant to a plan proposed on commencement, addressing the conduct of the business in reorganization and the transformation of legal rights proposed to address the debtor's financial situation. These will also be relevant, although not necessarily in their entirety, to other types of plans.

2. Nature or form of a plan

306. [263] The purpose of reorganization is to maximize the possible eventual return to creditors, providing a better result than if the debtor were to be liquidated and to preserve viable businesses as a means of preserving jobs for employees and trade for suppliers. With different constituents involved in the reorganization process, each may have different views of how that objective can best be reached. Some creditors, such as major customers or suppliers, may prefer continued business with the debtor to rapid repayment of their debt. Some creditors may prefer an equity stake in the business, while others will not. Typically, therefore, there is a range of options from which to select in a given case and if an insolvency law adopts a prescriptive approach to the range of options available or to the choice to be made in a particular case, it is likely to circumvent achievement of the goal of maximizing value. It is desirable that the law does not, for example, permit only a plan that is designed to fully rehabilitate the debtor; nor provide that debt cannot be written off; nor provide that a minimum amount must eventually be paid to creditors; nor prohibit exchange of debt for equity. [264] Such a non-intrusive approach is likely to provide the

flexibility sufficient to allow the most suitable (in terms of the particular entity) of a range of possibilities to be chosen. Some insolvency laws adopt an approach of listing some of the possibilities that may be adopted, but it is not intended that the list be exclusive of other approaches.

307. [263] These possibilities could include a choice of a simple composition (an agreement to pay creditors a percentage of their claims); the continued trading of the business and its eventual sale as a going concern (and for the debtor to then be liquidated); transfer of all or part of the assets of the estate to one or more existing businesses or to businesses that will be established; a merger or consolidation of the debtor with one or more other business entities; a sophisticated form of restructuring of debt and equity or some other solution. The determination of what is the most appropriate solution may best be left to the market place, where an effective one exists, or at least to negotiations among the debtor, the insolvency representative, creditors and other persons with economic interests.

308. [264] Even if it does not adopt a prescriptive approach to the form or nature of the plan, an insolvency law may establish some limits, such as that the priorities afforded to creditors in liquidation should be maintained in reorganization, that the effect of the plan should not be such that the debtor remains insolvent and is returned to the market place in that condition and that the reorganization plan comply with limitations set forth in other laws (where the insolvency law does not amend those limitations), for example foreign exchange controls.

3. Preparation of a plan

309. [265] Two important issues to be considered in relation to preparation of a reorganization plan are the stage of the proceedings at which it should be prepared and the party or parties that would be capable of preparing, or could be authorized to prepare, a plan. A number of different approaches can be taken to each of these issues.

(a) Timing of preparation

310. [266] As to the first issue, timing of preparation, the approach adopted may depend upon the purpose or objective of the particular reorganization, or relate to the manner in which the reorganization proceedings commenced. Some laws, for example, provide that the plan for reorganization should be filed with the application for reorganization proceedings (where the application may be called a "proposal" for reorganization) where those proceedings are voluntary proceedings commenced by the debtor. Potential difficulties with this approach may include delaying the debtor's ability to commence proceedings and obtain timely relief by way of the stay; the difficulty of knowing, at this early stage, exactly what the plan should accomplish; and if the plan has been prepared without consultation with creditors and other interested parties but is intended to be a final, definitive plan, it may not be a plan that could feasibly be implemented and could thus operate to pre-empt the proceedings and cause delay. Many other laws provide for the plan to be prepared after commencement of reorganization proceedings. This may be a more flexible option, allowing for consultation and negotiation of an acceptable reorganization plan while the debtor has the protection of the stay. These benefits may need to be balanced against possible misuse of the insolvency regime by debtors who have no intention of, or ability to, file a plan but are seeking to obtain only the benefits of the stay.

(b) Parties capable of preparing [permitted to prepare] a plan

311. [267] With regard to the second issue, participants in the reorganization proceedings may have different capabilities and responsibilities with regard to preparation of the reorganization plan, depending upon the manner in which the insolvency law is designed and in particular the respective roles assigned to the insolvency representative, debtor and creditors. For example, in some insolvency laws, these parties have a positive obligation to cooperate in preparing the plan. In determining which party should be permitted to prepare, or which parties are capable of preparing, the plan, a balance may be desirable between the freedom accorded to the different parties to prepare the plan (e.g. should all parties be able to prepare a plan, should they be able to do so at the same time or should preparation by different parties be sequential and dependent upon the acceptability of a plan proposed), and the restraints necessarily attached to the process in terms of approval (voting) requirements (e.g. should all creditors play a role in formulating a plan they have to approve), time limits for preparation, provision in the insolvency law for amendment of the plan and other procedural considerations. A flexible approach, as opposed to a prescriptive approach, is likely to ensure that this balance is achieved, although in the interests of efficiency, certainty and predictability and the timely progress of the proceedings, it is desirable that an insolvency law provide sufficient guidance to ensure that a viable plan is prepared.

(i) Preparation by the debtor

312. [268] Some insolvency laws provide for the debtor to prepare the reorganization plan, sometimes specifying that it should do so in cooperation with other parties such as the insolvency representative, the creditors, an attorney, an accountant or other financial advisors. An approach which involves the debtor may have the advantages of encouraging debtors to commence reorganization proceedings at an early stage and of making the best use of the debtor's familiarity with its business and knowledge of the steps necessary to make the insolvent entity viable (although the freedom accorded to the debtor may need to be balanced against the need to ensure creditor confidence in the debtor and its proposal). The opportunity provided to the debtor could be made exclusive or exclusive only for a specified period, with the court having the power to extend the period if it will be of advantage to the reorganization proceedings, and with another party able to prepare a plan where the period expires without a plan being proposed. Where the plan is to be prepared before commencement, it would generally be prepared by the debtor, but may involve negotiation with one or more classes of creditors, not necessarily all, who may negotiate and agree on a plan, subject to its acceptance by other creditors or its imposition on remaining classes.

(ii) Creditor participation

313. [269] Where creditor approval of the plan is required, there is always a risk that reorganization will fail if the plan presented by the debtor is not acceptable. For example, creditors may only wish to approve a plan that deprives the debtor's shareholders of a controlling equity interest in the insolvent entity and may also deprive the incumbent management of any management responsibilities. If the debtor is given the exclusive opportunity to prepare the plan and refuses to consider such an arrangement, there is a danger that the reorganization will fail, to the detriment of the creditors, the employees, and the debtor. There are benefits to be derived from providing for debtor participation in preparation of the plan, even if it does not have principal responsibility. These benefits

may be clear particularly where the plan envisages the ongoing operation of the debtor's business and key management personnel are necessary to the success of that business (such as for reasons of its complexity) or will be difficult to replace in the short term. To address these concerns, some insolvency laws provide that, if the debtor fails to provide an acceptable plan before the end of an exclusive period, the creditors are given the opportunity to propose a plan (which could be achieved through a creditor committee (see Part two, chapter IV.C). This option may provide the leverage necessary to reach a compromise between the participating parties.

(iii) Participation by the insolvency representative

314. [270] Another approach adopted by many insolvency laws is to give the insolvency representative an opportunity to prepare the plan, either as an alternative to preparation by the debtor or the creditors or as a supplementary measure. Given that the insolvency representative will have had some opportunity to become knowledgeable about the debtor's business after commencement of the proceedings, it may be well placed to determine what measures are necessary for the business to be viable. It may also be well placed to facilitate negotiations on the plan between the debtor and creditors. The importance of providing for participation by the insolvency representative or the creditors depends upon the design of the law. In circumstances where approval by the requisite majority of creditors is a necessary condition for effectiveness of the plan, a plan that takes account of proposals that will be acceptable to creditors has a greater likelihood of being approved than one which does not. This consideration will not apply where creditor approval is not necessary or can be overruled by the court. Where the plan is only to be approved by the court, substantial legal input may be required to ensure that the plan presented will be approved.

(iv) Preparation by multiple parties

315. [270] Some insolvency laws provide that a number of parties have the opportunity to prepare a plan. These may include management of the debtor, shareholders of the debtor, the insolvency representative, and creditors or the creditors committee. It may be desirable where such a provision is included that some procedure is adopted to ensure that a number of competing plans are not prepared simultaneously. Although in some cases this approach may promote the preparation of a mutually acceptable plan, it may also have the potential to complicate the process and lead to inefficiency and delay.

316. [271] Some laws provide for the court to consider the opinions of third parties on the plan, such as governmental agencies and labour unions. Although in particular cases this may assist in the preparation of an acceptable plan, it also has the potential to lengthen the duration of the process, and may be desirable only if it is likely to be beneficial in a particular case, where the process is carefully monitored and time limits are specified.

(c) Time limits for preparation of a plan

317. Some insolvency laws include a time limit within which the plan is to be prepared. This limit may specifically apply to preparation of the plan by the debtor or to preparation of the plan generally. One law, for example, provides a 120-day limit for preparation of the plan by the debtor; once that has expired any other party may submit a plan without any time limit being imposed. Examples of time limits generally applicable to preparation and submission of a plan include from 35 to 120 days from commencement, with some laws including provision for that time limit to be extended or shortened by the court in certain

circumstances. Although the imposition of time limits may be helpful in ensuring that the reorganization proceedings proceed without delay, that advantage may need to be balanced against the risk that the deadlines may be too inflexible and impose an arbitrary restraint, particularly in large cases where preparation of the plan may take more than 12 months, or that the limits will not be observed, especially in the absence of appropriate sanctions, or that the insolvency infrastructure is unable to manage deadlines (for reasons such as lack of resources). An advantage of time limits which can be extended by the court is that they require the party seeking an extension to demonstrate to the court that the extension is warranted—that is, for example, that there is no improper reason for the delay, that the delay will not be harmful to the proceedings and that there is a prospect for a successful reorganization.

4. The plan

318. [273] The question of what is to be included in the plan is closely related to the procedure for approval of the plan (for example, which creditors are required to approve the plan, the level of support required for approval and the procedure for court confirmation, if any) and the effect of the plan once approved (and confirmed by the court, where required) (for example, will it bind dissenting creditors and secured creditors, who will be responsible for implementation of the plan and for ongoing management of the debtor). The outcome of the plan rests on what is feasible, in other words whether, on the basis of known facts and circumstances and reasonable assumptions, the plan and the debtor are more likely than not to succeed. Determination of whether a plan is likely to succeed raises two related issues. The first is the content of the plan itself, or in other words what is proposed by the plan. The second is the manner in which those proposals are presented and explained to creditors in order to elicit their support.

(a) Content of a plan

319. [272] Many insolvency laws include provisions addressing the content of the reorganization plan. Some laws address the content of the plan by reference to general criteria, such as that the reorganization plan adequately and clearly disclose to all parties information regarding both the financial condition of the insolvent entity and the transformation of legal rights that is being proposed in the plan, or by reference to minimal requirements such as that the plan must make provision for payment of certain preferred claims.

320. Other laws set out more specific requirements as to what information is required in relation to the debtor's financial situation and the proposals included in the plan. [272] Information on the financial situation of the debtor may include asset and liability statements; cash flow statements; and information relating to the causes or reasons for the financial situation of the debtor.

321. [272] Information relating to what is proposed by the plan may include details of classes of claims; claims impaired under the plan and the treatment to be accorded to each class under the plan; the continuation or termination of contracts that are not fully executed; the treatment of unexpired leases; measures and arrangements for dealing with the debtor's assets (e.g. transfer, liquidation, retention); the sale of secured assets; the disclosure and acceptance procedure; the rights of disputed claims to take part in the voting process and provisions for disputed claims to be resolved; arrangements concerning personnel of the debtor; the role to be played by the debtor in implementation of the plan and identification of those to be responsible for future management of the debtor's

business; financing implementation of the plan; remuneration of management of the debtor for its services; the settlement of claims and how the amount that creditors will receive will be more than they would have received in liquidation; payment of interest on claims; possible changes to the form of the debtor (changes to by-laws, articles of association etc.); the basis upon which the business will be able to keep trading and can be successfully reorganized; supervision of the plan; and the period of implementation of the plan, including in some cases a statutory maximum period.

322. [274] The content of the plan also raises issues related to other laws. For example, to the extent that national company law precludes debt-for-equity conversions, a plan that provides for such a conversion could not be approved. Since debt-for-equity conversion can be an important feature of reorganization, it would be necessary to eliminate the prohibition, at least in the insolvency context, if such provisions were to be included in a plan and approved. Similarly, if a plan is limited by the operation of other law to debt forgiveness or the extension of maturity dates, it may not receive adequate support from creditors for it to be successful. Some insolvency cases raise similarly straightforward and uncontroversial issues of the relationship between the insolvency law and other laws. Other cases may raise more complicated questions. These may include limits on foreign investment and foreign exchange controls (especially in cases where many of the creditors are non-residents), or the treatment of employees under relevant employment laws where, for example, the reorganization may raise questions of modification of collective bargaining agreements, or questions related to taxation law. Some insolvency laws allow certain limitations contained in other laws, for example those relating to disposition of the debtor's assets and priority of distribution, to be overruled in specified circumstances, such as where creditors agree, and it is desirable, in order to ensure transparency and predictability, that an insolvency law specifically address the question of its relationship with other laws.

(b) Information to accompany the plan

323. [273] When voting on a plan, creditors need to be able to assure themselves that what is proposed by the plan is feasible and not based, for example, on faulty assumptions, and that implementation of the plan will not leave the debtor overburdened with debt. To facilitate that evaluation, creditors will need to be provided with information explaining what the plan proposes and the impact of those proposals on both the debtor and creditors. For these purposes, the plan can be accompanied by a report of a qualified professional who can be expected to provide a credible and unbiased assessment of the measures proposed by the plan or by a full disclosure of information from which creditors can evaluate the plan. Where creditors do not agree with the professional evaluation, or do not believe that the disclosed information is persuasive, those views could be taken into account either in voting on the plan, by a mechanism allowing for amendment of the plan, or by the court when it confirms the plan (where that is a required element of the process).

324. [272] A number of insolvency laws include provisions addressing the information that is to be provided to creditors to enable them to properly assess the plan, whether it is to be included in the plan itself or in a separate statement. Where the reorganization plan is to be accompanied by such a statement, the insolvency law may specify what information it should include. Provision of this information supports the key objective of transparency and can assist in ensuring creditor confidence in the insolvency process. It may need to be balanced, however, against confidentiality concerns arising from creditor access to potentially sensitive financial and commercial information relating to the debtor, even

where that information may ultimately enter the public domain through approval or confirmation of the plan by a court. It may also need to be balanced against the provision of information that is irrelevant to the purpose of evaluating the plan; the focus should be upon the information required in a particular case to evaluate the specific proposals contained in the plan.

5. Approval of a plan

325. [275] Designing the provisions of an insolvency law with regard to the approval of the plan requires a balance to be achieved between a number of competing considerations, which will be particularly important where the plan does not receive the support of all creditors or classes of creditors. On the one hand, it will be essential to provide a way of imposing an agreed plan upon a minority of dissenting creditors within a class in order to increase the chances of success of the reorganization. It may also be necessary, depending upon the mechanism that is chosen for voting on the plan and whether creditors vote in classes, to consider whether the plan can be binding upon dissenting classes of creditors. To the extent that a plan can be approved and enforced upon dissenting creditors, there may be a need to ensure that the content of the plan provides appropriate protection for those dissenting creditors and, in particular, that their rights cannot be unfairly affected. On the other hand, to the extent that the approval procedure results in a significant impairment of creditors' claims without their consent (particularly secured creditors), there is a risk that the willingness of creditors to provide credit in the future may be undermined. The mechanism for approval of the plan, and the availability of appropriate safeguards, is therefore of considerable importance to the protection of these interests.

(a) Procedures for approval

326. [275] Many insolvency laws provide for a special meeting of creditors to be called for the purpose of voting on the reorganization plan, and require that the plan (and the information or disclosure statement where that document is also to be provided) be made available to the creditors within a certain period of time before that meeting is called. [210] Some laws provide that voting should occur in person at a meeting of creditors, while other laws provide that voting may take place by mail or by proxy. It may also be desirable to recognize that voting can take place using electronic means.

327. Other issues to be considered with regard to approval of the plan include the types of claims (in terms of admission or provisional admission of those claims) that will be considered in determining whether the requisite majority has been reached, whether secured creditors are required to vote; whether the votes of priority claims will be considered in determining the requisite majority, and the manner in which abstaining creditors will be treated. In some cases, for example, abstaining voters are treated as votes not to accept a plan, [280] while many countries adopt the approach of calculating the percentage of support on the basis of those actually participating in the voting and absentees and abstaining voters are considered to have little interest in the proceedings. The latter approach requires adequate notice provisions and their effective implementation, especially where creditors are non-residents.

328. Some insolvency laws also make use of presumptions regarding votes. Where, for example, a plan cancels a creditor's claim or owner's equity interest (and that party receives nothing under the plan), a vote against the plan can be presumed. In contrast, where a plan leaves a claim unimpaired or provides that it will be paid in full, a vote in

favour of the plan can be presumed. Such presumptions may simplify the voting procedure, and lessen the need to provide notice and information to relevant creditors.

(b) Approval by secured and priority creditors

329. [276] In many cases, secured claims will represent a significant portion of the value of the debt owed by the debtor and different approaches may be taken to approval of the plan by secured and priority creditors. As a general principle, however, the extent to which a secured creditor is required to vote will depend upon the manner in which the insolvency regime treats secured creditors, the extent to which a reorganization plan can affect the secured interest of the secured creditor and the extent to which the value of secured asset will satisfy the claim of the secured creditor.

330. Under one approach, where the insolvency law ensures that an approved plan will not preclude secured creditors from exercising their rights against the secured assets, there is generally no need to give these creditors the right to vote since their security interests will not be impaired by the plan. Priority creditors are in a similar position under this approach—the plan cannot impair the value of their claims and they are entitled to receive full payment. The limitation of this approach, however, is that it may reduce the chances for a successful reorganization, especially where the secured assets are vital to the success of the plan. If the secured creditor is not bound by the plan, the election by the secured creditor to exercise its rights, such as by repossessing and selling the secured asset, may make the plan impossible to implement. Similarly, in certain circumstances, the only way in which the plan may succeed is to provide that priority creditors receive less than the full value of their claims upon approval of the plan. Thus, the prospects for reorganization may improve if priority creditors will accept payment over time and if secured creditors will acquiesce when the terms of the security are modified over time.

331. To the extent that the value of the secured asset will not satisfy the full amount of the secured creditor's claim, a number of insolvency laws provide for them to vote with ordinary unsecured creditors in respect of the unsatisfied portion of the claim. In some legal systems, this raises difficult questions of valuation in order to determine whether and the extent to which all secured creditors are in fact secured. For example, where three creditors hold security over the same asset, the value of that asset may only support the claim first in priority and part of the second in priority. The second creditor may therefore be required to vote in respect of the unsecured portion of its claim, while the third creditor will be totally unsecured. The valuation of the asset is therefore crucial to the determination of whether or not a creditor is secured and the extent of its security, a determination which becomes important where secured creditors are not required to vote on a plan (but where they do vote can be bound by the plan), but where unsecured creditors are required to vote.

332. [277] There are a variety of different approaches to secured creditor voting on a reorganization plan. Some insolvency laws provide for secured and priority creditors to vote as separate classes on a plan that would impair the value or terms of their claims or to otherwise consent to be bound by the plan. This approach recognizes that the respective rights and interests of these creditors differ from those of unsecured creditors, and from each other. Where secured creditors vote in classes, some insolvency laws provide that to the extent that the requisite majority votes to approve the plan, dissenting members of the class will be bound by the terms of the plan. The requisite majority would generally be the same as that required for approval by unsecured creditors, although there are examples of laws that require different majorities depending upon the manner in which secured

creditors rights are affected (e.g. a three-quarter majority is required where the maturity date is extended and a four-fifths majority where the rights are otherwise impaired). Other insolvency laws provide that the plan cannot be imposed upon secured creditors unless they consent to such imposition.

333. A further approach is those insolvency laws which provide that dissenting secured creditors are entitled to receive at least as much as they would have received under liquidation and only where that occurs can they be bound by the plan. An alternative provides that they may be bound if the plan makes provision for them to be paid in full to the extent of the value of their security, with interest, within a certain period of time. Some insolvency laws also provide that secured creditors may be bound by the plan where the court has the power to order that they are bound, provided it is satisfied as to certain conditions. These may include that enforcement of the security by the secured creditor will have a material adverse effect on achieving the purposes of the plan and that the security interests of the secured creditor will be sufficiently protected under the plan and that the position of the secured creditor will not further deteriorate under or as a result of the plan (for example, payments of future interest will be made and the value of the secured interest will not be affected).

334. In determining which approach should be taken to this issue, it will be important to assess the effect of the desired approach upon the availability and cost of secured transaction financing and to provide as much certainty and predictability as possible.

(c) Approval by ordinary unsecured creditors

335. [278] Different mechanisms may be used to ensure that ordinary unsecured creditors have an effective means for voting on a plan. Whichever mechanism is chosen it is desirable that it be as simple as possible and be clearly set out in the insolvency law to ensure predictability and transparency.

(i) Classes of unsecured creditors

336. A number of insolvency laws do not provide for unsecured creditors to be divided into different classes, rather they vote together as a single group. Other insolvency laws do provide for division into classes where there is a large number of unsecured creditors or where unsecured creditors have different interests based upon the nature of their claims. Where there is a small number of unsecured creditors or where their interests are similar, there may be no need for creditors to vote on approval of the plan in different classes, thus simplifying the voting procedure.

337. [281] Countries that have established classes for secured and priority creditors often also provide for the division of ordinary unsecured creditors into different classes, based upon their varying economic interests. The creation of these classes is designed to enhance the prospects of reorganization in at least three respects by providing: a useful means of identifying the varying economic interests of unsecured creditors; a framework for structuring the terms of the plan; and a means for the court to utilize the requisite majority support of one class to make the plan binding on other classes which do not support the plan. Since the creation of different classes has the potential to complicate the voting procedure, it may be desirable only where there are compelling reasons for special treatment of some ordinary unsecured creditors, such as a lack of common economic interests. Criteria that may be relevant in determining commonality of interest may include: the nature of the debts giving rise to the claims; the remedies available to the

creditors in the absence of the reorganization plan and the extent to which the creditors could recover their claims by exercising those remedies; the treatment of the claims under the reorganization plan; and the extent to which the claims would be paid under the plan.

(ii) Determination of classes

338. Some insolvency laws specify the manner in which classes of ordinary unsecured creditors or claims are determined for the purposes of approval of the reorganization plan. One approach is for the plan to place claims or interests into a particular class on the basis of common interest or substantial similarity or on the basis of the value of the claim. Where the test is commonality or similarity of interest, the person who prepares the plan may have some flexibility in assigning claims to a particular group. Another approach provides for the insolvency representative to make recommendations to the court before the creditors vote on approval. A further approach provides that the classes are determined in the first instance by the debtor, who will have some limited flexibility as to the composition of each class; unsecured creditors who are unsatisfied by the composition of the class can seek to have the issue determined by the court.

(d) Approval by shareholders

339. [283] Some insolvency laws provide for the approval of reorganization plans by shareholders of the debtor, at least where the corporate form, the capital structure or the membership of the debtor will be affected by the plan. Shareholders may also be expected to vote where some shareholders will receive a distribution under the plan. Where the debtor's management proposes a plan, the terms of the plan may already have been approved by the shareholders (depending upon the structure of the debtor in question, this may be required under its constitutive instrument). This is often the case where the plan directly affects shareholders such as by providing for debt-for-equity conversions, either through the transfer of existing shares or the issuance of new shares.

340. [284] In circumstances where the insolvency law permits creditors or an insolvency representative to propose a plan, and the plan contemplates debt-for-equity conversion, some insolvency laws allow the plan to be approved over the objection of shareholders, irrespective of the terms of the constitutive instrument of the entity. Such plans may result in existing shareholders being entirely displaced without their consent, subject to some protections. Where, for example, the reorganization plan provides for some return to shareholders, they cannot be displaced.

(e) Related person creditors

341. [285] Some insolvency laws provide that related persons should not vote with other creditors on approval of the plan or that their votes will not count for certain purposes such as determining that an impaired class of creditors has accepted the plan (when that is a requirement of approval). Many insolvency laws, however, do not include provisions dealing specifically with this issue. Where the insolvency law makes no special provision, related persons should vote in the same manner as other creditors. They will generally be subject, however, to the provisions of non-insolvency law for their personal dealings with the debtor and its business.

(f) Majorities required for approval of the plan

342. [279] Many insolvency laws identify the minimum threshold of support required from creditors for the plan to be approved. The requisite majority can be calculated in a number of different ways, depending upon whether or not creditors vote in classes, and how those classes are treated in determining the majority. Where creditors do not vote in classes, the majority may be fixed by reference to the support of a proportion or percentage of the value of claims or a number of creditors, or a combination of both. Some laws require, for example, that the plan be supported by at least two-thirds or three quarters of the total value of the debt and more than one-half or two-thirds of the number of creditors. While these proportions generally apply to creditors voting on approval of the plan, there are laws which determine these proportions by reference to the total value of debt and total number of creditors, irrespective of whether or not they vote. Other combinations are also used.

343. [279] Where creditors do vote in classes, a wide variety of different approaches are taken to determining when a plan will be approved. Some insolvency laws require a majority of each class of creditors based upon a percentage or proportion of the value of claims or a number of creditors, or a combination of both. Other laws establish the requisite majority of creditors within a class, as well as what will constitute a majority of classes. For example, a simple majority of the classes may be required, or where less than a majority of classes support the plan, the plan may nevertheless be made binding on dissenting creditors, both within a class that otherwise supports the plan and where a class does not support the plan, provided the court is satisfied certain conditions are met (see Binding dissenting creditors and Court confirmation below). One law, for example divides claims into three classes and provides that the plan must be approved by at least two of those classes, and that at least one of the approving classes would not recover the full amount of their claims if the debtor were to be liquidated. Another variation requires that at least one of the classes approving the plan will have its rights impaired under the plan, to ensure that the plan is not only supported by those creditors whose rights are not impaired. Other laws provide that support by classes of unsecured creditors cannot force approval of plan if secured creditors oppose the plan.

344. [279] Although increasing the difficulty of achieving approval, a procedure which includes both value of claims and number of creditors may be justified on the basis that it protects the collective nature of the proceedings. For example, if a single creditor holds a majority of the value, such a rule prevents that creditor from imposing the plan on all other creditors against their will. Equally, such a provision may prevent a large creditor from imposing its lack of support for the plan on other creditors to their detriment, although there are examples of laws that do provide creditors holding more than a certain percentage of the total value of claims with a power to veto approval or to force an improvement of the terms of the plan for the benefit of all creditors. A voting procedure which combines the value of claims with a number of creditors will also prevent a large number of very small creditors from imposing their decision on a few creditors who hold very large claims. Some insolvency laws include provisions to the effect that even where a majority of the number of creditors support a plan, where those creditors represent less than a certain percentage of value of the total claims (e.g. around 25 or 30 per cent), the court will be reluctant to approve or confirm the plan. This procedure may also be justified on the basis that it helps to ensure the support for the plan is sufficient to enable it to be successfully implemented.

6. Where the plan is submitted to creditors for approval but is not approved

(a) Modification of a plan

345. [291] Where a vote on a reorganization plan fails to achieve the level required for the plan to be approved, an insolvency law may adopt a mechanism that could lead to modification and reconsideration of the plan by creditors. One approach, for example, may be to allow a majority of creditors to vote to adjourn the decision meeting to enable further disclosure, if it appears that some further negotiation on a plan may produce a favourable result or to address unresolved disputes and issues. As with all areas of the insolvency process, however, it is desirable that that adjournment be available in limited circumstances or at least a limited number of times, with perhaps time limits being included to facilitate speedy resolution of the renegotiations and avoid abuse.

(b) Conversion of proceedings

346. [294] In cases where a reorganization plan is not approved and modification of the plan will not resolve the difficulties encountered, an insolvency law may adopt different approaches to the further conduct of the proceedings. Some insolvency laws provide that the failure by creditors to approve the plan should be taken as an indication that they favour liquidation and the reorganization proceedings can be converted to liquidation. This approach may operate to encourage debtors to propose an acceptable plan, safeguards to prevent abuse in cases where liquidation is not in the interests of all creditors may be appropriate. Where reorganization proceedings are converted to liquidation, an insolvency law will need to consider the status of any actions taken by the insolvency representative prior to approval of the plan, as well as the continued application of the stay, particularly to secured creditors when the insolvency law contains a time limit (see Part two, chapter III.B.4(c) and recommendation (40)). Other insolvency laws provide that the reorganization proceedings should be dismissed. This approach has the disadvantage of leaving the debtor in a state of financial difficulty, where further debts may accrue and the value of the assets diminish, and postponing the commencement of the liquidation proceedings that may be inevitable.

7. Binding dissenting creditors

347. [282] A few countries that provide for voting by secured and priority creditors and for the creation of different classes of unsecured creditors also include a mechanism that will enable the support of one or more classes to make the plan binding on other classes (including, under some laws, classes of secured and priority creditors) which do not support the plan. This is sometimes referred to as a "cram-down" provision. Where such provisions are incorporated in the insolvency law, the law also generally includes conditions that are aimed at ensuring the protection of the interests of those dissenting classes of creditors. Since it is generally the court that is required to consider whether these conditions have been satisfied, they are discussed in the following section.

8. Court confirmation of a plan

348. [287] Not all countries require the court to confirm a plan that has been approved by creditors; approval by the requisite majority of creditors is all that is required for the plan to be effective and dissenting creditors will be bound by virtue of the operation of the insolvency law. In those systems, the court, however, may have a role to play with regard

to review of the plan where minority creditors challenge the plan itself or the means by which it was procured.

(a) Objections to approval of the plan

349. Many insolvency laws provide for objections to the approval of the plan to be made at the confirmation hearing, and a number establish the grounds for objection. [290] These may include that approval of the plan was obtained by fraud (e.g. false or misleading information was given or material information was withheld with respect to the reorganization plan); that there was some irregularity in the voting procedure (e.g. related persons participated where this is not permitted under the insolvency law or the resolution approving the plan was not consistent with the interests of creditors generally); that there was some irregularity in the conduct of the meeting at which the vote was taken; that the proposals contained in the plan were put forward for an improper purpose; that the plan is not feasible (e.g. secured assets are required for successful implementation of the plan, but secured creditors are not bound by the plan and no agreement has been reached with relevant secured creditors concerning enforcement of their security interests); that the plan does not satisfy the requirements for protection of dissenting creditors within a class (e.g. they will not receive as much under the plan as they would have received in liquidation, unless they have agreed to receive lesser treatment under the plan); or that the proposals unfairly prejudice the interests of the objector. Since all creditors are likely to be prejudiced to some degree by reorganization proceedings, a level of prejudice or harm that exceeds the prejudice or harm suffered by other creditors or classes of creditors would generally be required. Where the creditor challenging the plan voted in favour of the plan, the grounds for challenge may be limited, for example, to fraud and other impropriety. Where the challenge to the plan is successful, an insolvency law may provide that the plan can be reconsidered by creditors or set aside.

(b) Steps required for court confirmation

350. [288] Where the insolvency law requires the court (or in some countries an administrative authority) to confirm a plan, it would normally be expected to confirm a plan that has been approved by the requisite majority of creditors (whether voting in classes or otherwise). Many countries enable the courts to play an active role in "binding in" creditors by making the plan enforceable upon a class of creditors that has not approved the plan. This may require the court to undertake a role that is in the nature of a legal formality; it does not require the court to examine the commercial basis upon which the plan was approved but to ensure that the decision of the creditors was properly obtained (i.e. there is no evidence of fraud in the approval process) and that certain conditions were satisfied. These conditions may include, for example, that those classes of creditors objecting to the plan will share in the economic benefits of the plan, that no creditor will receive more than the full value of their claim, that normal ranking of claims is recognized by the plan and that similarly situated creditors are treated equally (of course, some insolvency laws provide that creditors can agree to dispense with normal ranking and to different treatment of similarly situated creditors). Under some laws, the court may also be required to assess additional matters, such as that the plan is fair in respect of those classes which have accepted the plan, but whose interests are impaired by the plan, and that the interests of dissenting classes of creditors have been adequately protected (because, for example, they will receive as much under the plan as they would have received in liquidation, unless they have agreed to receive lesser treatment under the plan).

351. [289] Some insolvency laws also give the court the authority to reject a plan on the grounds that it is not feasible or impossible to implement. This may be justified, for example, where secured creditors are not bound by the plan but the plan does not provide for full satisfaction of the secured claims of these creditors. The court may reject the plan in such a case if it considers that secured creditors will exercise their rights against the secured assets, thus rendering the plan impossible to perform. The risk of this occurring can be addressed in provisions relating to preparation and approval of the plan.

352. The more complex the decisions the court is required to make in terms of approval or confirmation, the more relevant knowledge and expertise is required of the judges, and the greater the potential for judges to interfere in what are essentially commercial decisions of creditors to accept or reject a plan. [289] It is desirable, in particular, that the court not be asked to review the economic and commercial basis of the decision of creditors unless it has the competence and experience to do so, nor that it be asked to review particular aspects of the plan in terms of their economic feasibility, unless they have the competence to do so. For these reasons, it is desirable that the requirements for approval of the plan are carefully designed to minimize potential problems arising after these requirements have been satisfied.

9. Effect of a plan

353. [286] Where the plan is approved by the requisite majority of creditors and, where required, confirmed or approved by the court, insolvency laws generally provide that it will be binding upon all affected ordinary unsecured creditors, including creditors who voted in support of the plan, dissenting creditors and creditors who did not vote on the plan. Some insolvency laws also provide that the plan will bind directors, shareholders and members of the debtor, and other parties as determined by the court. Some insolvency laws stipulate that the parties who are bound will be prevented from applying to the court to have the debtor liquidated (except where implementation fails or the debtor fails to perform as required under the plan), to start or continue legal proceedings against the debtor or to pursue enforcement without approval of the court. Some laws also provide that once the plan is approved by creditors and approved or confirmed by the court (where that is required), the property of the insolvency estate returns to the control of the debtor for implementation of the plan and a debtor may obtain a discharge of debts and claims pursuant to the plan.

10. Challenges to a plan after confirmation

354. [290] Many insolvency laws provide for the plan to be challenged subsequent to the confirmation hearing (in some cases within a specified time period). The grounds for challenge after confirmation may be narrower than the grounds for challenge at the time of confirmation and be limited, for example, to fraud. Where a challenge to a plan that has already been confirmed is successful, an insolvency law may adopt one of a number of possible options, for example that the plan be set aside and the proceedings converted to liquidation or that the debtor be left in its state of financial difficulty and the assets returned to its control. The latter approach does not resolve the debtor’s financial difficulty and may simply delay commencement of liquidation proceedings and lead to further diminution of the value of the debtor’s assets. In determining the most appropriate action to be taken in these circumstances, consideration will need to be given to the extent to which the plan has already been implemented and how steps taken in the implementation, such as payments to creditors, are to be treated.

11. Modification of a plan after approval by creditors (and confirmation by the court)

355. [292] An insolvency law may include provision for a plan to be modified after it has been approved if its implementation breaks down or it is found to be incapable of performance. Of those insolvency laws that allow modification, some provide for the plan to be modified if the modifications proposed will be in the best interests of creditors. Other laws provide that the plan can be modified if circumstances warrant the modification and if the plan, as modified, continues to satisfy the requirements of the insolvency law concerning, for example, content, classes of creditors and notice to creditors.

356. Depending upon the nature of the modification it may not be necessary to obtain the approval of all classes of creditors but only those affected by the modification. Since in some cases obtaining this approval may prove difficult, an alternative approach may be appropriate. These alternatives may include providing that small modifications can be approved by the court or that creditors who supported approval of the plan should be notified of the proposed modification and can object to that modification within a specified time period or otherwise be deemed to have accepted the modification. The same approach may be taken to creditors who did not approve of the plan. Where the modification proposed is significant, the approval of all creditors may be required. [292] Where the court has confirmed the original plan, it may also be required to confirm the modification to the plan.

12. Implementation of a plan

357. [293] Many plans can be executed by the debtor without the need for further intervention by the court or the insolvency representative. But sometimes it may be necessary for the implementation to be supervised or controlled by an independent person. Several insolvency laws provide that the court has an ongoing role in supervision of the debtor after approval and confirmation of the plan, pending completion of implementation. This may be important where issues of interpretation of the performance or obligations of the debtor or others arise. Some countries permit the court to authorize continued supervision of the affairs of the debtor, to varying degrees, by a supervisor or insolvency representative after the confirmation of the plan.

13. Where implementation fails

358. Where the debtor defaults in performing the plan or implementation of the plan breaks down for some other reason, some insolvency laws provide that the plan will be terminated, and the debtor liquidated. In that liquidation, insolvency laws generally provide that creditors claims which might have been compromised in the reorganization will be reinstated to the full amount. Other laws provide that the plan will only be terminated in respect of the obligation breached (it otherwise remains valid). The creditor in question is not bound by the plan and will have its claim restored to the full amount. In some cases, this will only occur where the debtor has fallen significantly into arrears[1] in the performance of the plan. In some countries, the consequences of default may be set out in the plan itself.

359. [295] Conversion to liquidation will provide certainty as to the ultimate resolution of the proceedings, although it may lead to further delay and diminution of value if the

[1] In one law, this requires a demand from the creditor for payment of the due liability and failure by the debtor to comply within a minimum period of time of at least 2 weeks.

liquidation proceedings are required to commence as if they were new proceedings. A further approach may be to regard the insolvency proceedings as at an end and allow creditors to take individual actions. This approach does not resolve the financial difficulties of the debtor and could lead to a race for assets that the commencement of collective proceedings was intended to avoid. A compromise approach may be to allow the proposal of a different plan by creditors within a specified deadline and only in situations where no plan can be prepared would liquidation follow. It must be recognized that at some point the balance between achieving the best outcome for all creditors and achieving what is feasible tips in favour of pursuing what is feasible, and it is desirable that an insolvency law be sufficiently flexible to allow this to occur.

14. Conversion to liquidation

360. [296] A number of circumstances may arise in the course of a reorganization proceeding where it may be desirable for an insolvency law to provide a mechanism to convert the proceedings into liquidation. In addition to circumstances where the reorganization plan cannot be approved or where the debtor defaults in implementation of the plan, it may be appropriate to consider conversion where it is determined that there is no reasonable likelihood of the business being successfully reorganized; where it is apparent that the debtor is misusing the reorganization process either by not cooperating with the insolvency representative (e.g. withholding information) or otherwise acting in bad faith (e.g. making fraudulent transfers); where the business continues to incur losses or where administrative expenses are not paid. Because it is the party that, after the debtor or its management, has the greatest knowledge of the debtor's business, and so often learns at an early stage whether or not the debtor's business is viable, the insolvency representative can play a key role in the conversion process. In addition, it may be reasonable to allow creditors or the creditor committee (where one has been appointed), to request the court to convert the proceedings on similar grounds. The court could also be given the power to convert on its own motion where certain conditions are met, for example […].

Recommendations

Purpose of legislative provisions

The purpose of provisions relating to the reorganization plan is to:

(a) Facilitate the rescue of ~~financially troubled~~ businesses subject to the insolvency law, thereby protecting investment and preserving employment;

(b) Facilitate maximization of the value of the insolvency estate;

(c) Facilitate the negotiation and approval of a reorganization plan and establish the effect of approval, including a mechanism to make an approved plan binding on all creditors and other interested parties;

(d) Address the consequences of a failure to propose an acceptable reorganization plan or inability to have the plan approved by creditors, including conversion of the proceedings to liquidation in certain circumstances;

(e) Provide for the implementation of the reorganization plan, including discharge of debts and claims, and the consequences of failure of implementation.

Content of legislative provisions

Preparation of the plan—timing

(121) [(125)] The insolvency law should provide that the reorganization plan is [prepared] [filed] on or after the making of an application to commence insolvency proceedings, or within ~~but no later than the end of~~a specified time period after commencement of the insolvency proceeding.

(a) The time period should ~~may~~ be ~~set by the court or alternatively~~fixed by the insolvency law.

(b) The court should be authorized to extend the time period in appropriate circumstances.

Preparation of the plan—parties [permitted] [capable]

(122) [(126)] The insolvency law should ~~specify~~identify the parties ~~responsible~~[permitted to propose] [capable of proposing] ~~for the preparation of the~~ a reorganization plan for approval by creditors.

(123) [(127)] In providing for the preparation of the reorganization plan, the insolvency law should adopt a flexible approach that potentially involves all parties central to the insolvency proceedings, i.e. the debtor, the creditors [although a plan need not impair or alter the rights of every class of creditor] and the insolvency representative. The insolvency law may combine different elements:

(a) An exclusive period may be given to one party to propose a plan. To encourage debtors to apply for commencement of proceedings at an early stage of financial difficulty, it [may] [should] be the debtor that is given that opportunity. The party provided with the exclusive period may be required to consult with other parties in order to ensure that the most acceptable plan will be proposed;

(b) Where no ~~acceptable~~ plan is forthcoming within the exclusive period, other parties, such as the insolvency representative, creditors or the creditors committee in collaboration with the insolvency representative may be given the opportunity to propose a plan, or the court may extend the exclusive period if the party which has the exclusive period can show that an extension is warranted [such as by showing that the delay is justified and that there is a real prospect for reorganization].

Content of the plan

(124) [(128)] The insolvency law should specify the minimum contents of a reorganization plan, which should include:

(a) Detail as to the classes of creditors and the treatment provided for each class by the plan (e.g. how much they will receive and the timing of payment);

(b) The terms and conditions of the plan, including:

(i) Treatment of contracts, including ~~employment~~labour contracts;

(ii) The debtor's role in implementation of the plan, including control over assets;

(c) Means for the implementation of the plan which may include:

(i) The possibility of sale of all or any part of the debtor's business;

(ii) Proposed changes in the capital structure of the debtor's business;

(iii) Amendment of the debtor's charter;

(iv) Merger or consolidation of the debtor with one or more persons;

(v) Extension of a maturity date or a change in an interest rate or other term of outstanding securities;

(vi) Distribution of all or any part of the assets of the insolvency estate among those having an interest in those assets;

(vii) Identification of those responsible for future management of the entity;

(viii) Supervision of the implementation of the plan.

[*Explanatory*] [*disclosure*] *statement*

(125) [(129)] The insolvency law should require a reorganization plan submitted for the approval of creditors to be accompanied by a [explanatory] [disclosure] statement that will enable creditors to make an informed decision about the plan. The statement should be prepared by the same party as prepares the reorganization plan, be submitted to creditors at the same time as submission of the reorganization plan and include:

(a) Information relating to the financial situation of the debtor including asset and liability and cash flow statements;

(b) A comparison of the treatment afforded to creditors by the plan and what they would otherwise receive in liquidation;

(c) The basis upon which the business would be able to keep trading and could be successfully reorganized; and

(d) Information showing that, having regard to the effect of the plan, the assets of the debtor will exceed its liabilities and the debtor will have the cash flow to pay its [matured debts] [its debts as provided in the plan].

Submission of the plan and [explanatory] [disclosure] statement

(126) The insolvency law should provide a mechanism for submission of the reorganization plan and [explanatory] [disclosure] statement to creditors.

Voting mechanisms

(127) [(130)] The insolvency law should establish a mechanism for voting on approval of the reorganization plan. This mechanism should address the creditors who are required to vote on the plan; the manner in which the vote can be conducted, either at a meeting of creditors convened for that purpose or by mail or other means, including electronic means and the use of proxies; and whether

or not creditors should vote in classes according to their respective rights or as a general body of creditors.

Approval of the plan by creditors of a particular class

(128) [(131)] The insolvency law should establish the majority required for approval of the reorganization plan by a particular class of creditors. Where the required majority of creditors in that class supports the plan, that class of creditors will be regarded as supporting the plan. The majority should be limited to those creditors actually voting, whether in person or by proxy. A majority based on unanimity or a simple majority of the number of creditors voting is not recommended. Alternative approaches may include a combination of the number of creditors voting and the amount of claims, in proportions such as a simple majority of the number of creditors voting combined with a simple or greater (for example, two-thirds) majority in amount of the claims of those voting.

Approval by majority of classes of creditors

(129) Where creditors vote on approval of the reorganization plan in classes, the insolvency law may require approval by a specified majority of classes.

(130) [(132)] The insolvency law should address the treatment of those classes of creditors which do not vote in support of the reorganization plan in those cases where the plan satisfies the requirements for approval and is approved by the requisite majority.

Objections to approval

(131) [(135)] The insolvency law should allow interested parties, including the debtor, to object to the approval of the reorganization plan before it is confirmed or otherwise becomes binding on creditors ~~and specify the time at which that challenge may be made~~. The law may include criteria against which the challenge can be assessed, including that:

(a) the approval process was improperly conducted;

(b) creditors will not receive at least as much under the plan as they would have received in liquidation, unless they agree to receive lesser treatment; or

(c) the plan contains provisions forbidden by law.

Effect of the plan

(132) The insolvency law should provide that an approved reorganization plan will bind the debtor, creditors, stakeholders and any other person [specified in the plan], either by operation of the insolvency law or through confirmation of the plan by the court.

Confirmation of the plan

(133) [(133)] Where the insolvency law provides for the court to confirm the reorganization plan, the court should ~~refuse to~~confirm the plan if:

(a) Requirements of the insolvency law for notice of commencement of proceedings; preparation and submission of the plan and disclosure statement; and approval of the plan ~~process was improperly conducted~~ are met;

(b) The plan does not contain provisions forbidden by law;

(c) Creditors will receive at least as much under the plan as they would have received in liquidation, unless they have agreed to receive lesser treatment.

Post-approval [post-confirmation] amendment of the plan

(134) [(136)] The insolvency law should include limited provision for amendment of the reorganization plan, specifying the parties that may propose amendments and the time at which the plan may be amended. The limited circumstances in which the plan may be amended may include where, after approval [and confirmation], implementation of the plan breaks down or the plan is found to be incapable of implementation in whole or in part, and the matter can be ~~easily~~ remedied.

Approval of amendments

(135) [(136)] The insolvency law should address the mechanism for approval of amendments to the plan. ~~The amended plan should be subject to~~ That mechanism may require notice to and approval by the creditors and satisfaction of the rules for confirmation, or [*other requirements?*].

Challenges to the plan after confirmation [during implementation]

(136) The insolvency law may provide for the plan to be challenged once it has been confirmed on the basis of improper conduct of the approval process, obtaining of the approval by fraud or [*other grounds?*].

Supervision of implementation

(137) [(137)] The insolvency law may establish a mechanism for supervising implementation of the plan, including supervision by the court, or by a court appointed supervisor, by the insolvency representative, or by a creditor-appointed supervisor.

Failure of implementation

(138) [(138)] The insolvency law should provide that where implementation of the reorganization plan fails and the plan cannot be amended, the proceedings should be converted to liquidation. Payments made in the course of the implementation of the plan should be protected from the operation of avoidance powers in any subsequent liquidation.

~~(a) the plan can be terminated; and~~

~~(b) if the reorganization proceedings have not closed, the proceedings can be converted to liquidation.~~

~~*Closing [and reopening] of proceedings*~~

~~(139) After an insolvency estate is fully administered [and the insolvency representative discharged] the court should close the proceedings.~~

~~(140) [*reopening*]~~

B. (Expedited) reorganization proceedings [Recognition of a reorganization plan negotiated and agreed prior to commencement of reorganization proceedings]

1. Introduction

361. As discussed above in Part one of the Guide, reorganization can take one of several forms including, principally, reorganization conducted under the formal supervision of a court or administrative body (the main form of reorganization discussed in this Guide) and informal or out-of-court reorganization (sometimes referred to as voluntary reorganization) which requires little or no court involvement and essentially depends upon the agreement of the parties involved. Because many of the costs, delays and procedural and legal requirements of a formal reorganization proceedings can be avoided where out-of-court reorganization procedures are used, they often can be the most cost-efficient means of resolving a debtor's financial difficulties. [A/CN.9/507, para. 244] As such these types of procedure can be valuable tools in the range of insolvency procedures available to a country's commercial and business sector.

362. [507/para. 244] Encouraging the use of out-of-court reorganization need not stem from the fact that a country's formal insolvency system is poor, inefficient or unreliable, but rather from the advantages such reorganizations can offer as an adjunct to a formal insolvency system which delivers fairness and certainty.

2. Out-of-court reorganization

(a) Creditors typically involved

363. [507/para. 244] An out-of-court reorganization typically involves negotiations between the debtor and one or more classes of creditors, such as lenders, bondholders and shareholders. They also frequently involve major non-institutional creditors, typically where such creditors' involvement is so considerable that an effective restructuring is not possible without their participation. These types of creditors often find it advantageous to participate in out-of-court reorganization because there is a potential to reduce the loss that they would otherwise suffer under full court-supervised insolvency proceedings.

364. The limited classes of creditors that would normally participate in out-of-court proceedings makes them easier to accomplish than full court-supervised reorganization, which typically affect all claims, including trade, employee and governmental claims. [507/para. 244] It is usual in out-of-court reorganization for these types of non-institutional creditors to continue to be paid in the ordinary course of business. On that basis, these creditors are not likely to have any objection to the proposed restructuring and therefore do not need a voice in the process. Where, however, such creditors were not, or ceased to be, paid in the ordinary course of business, they would have the right to commence full proceedings under the insolvency law.

(b) Impediments to achieving consensus

365. Out-of-court reorganization is often 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 certain existing classes of debt. These problems are magnified in the context of complex, multinational businesses, where it is especially difficult to obtain consents from all relevant parties. To assist the conduct of out-of-court reorganization, the International Federation of Insolvency Professionals (INSOL) developed the *Principles for a global approach to multi-creditor workouts*. [A/CN.9/WG.V/WP.55, para. 10] The Principles are designed to expedite out-of-court processes and increase the prospects of success by providing guidance to diverse creditor groups about how to proceed on the basis of some common agreed rules (for the text of the Principles see …).

366. Out-of-court reorganization can also be impeded by a minority of affected creditors who may refuse to agree to a reorganization that is in the best interests of most creditors in order to take advantage of their position to extract better terms for themselves at the expense of other parties (often referred to as “holding out”). Where these hold-outs occur, the negotiated agreement can only go ahead if by some means the contractual rights of these dissenting creditors can be modified without their consent. [507/para. 244] Under most existing legal systems, such a modification of contractual rights requires the out-of-court reorganization to be converted to a full court-supervised reorganization proceeding under the insolvency law, involving all creditors and including standards of treatment that appropriately protect the interests of dissenting creditors. Timing is typically critical in business reorganization and delay (usually inherent in full court-supervised insolvency proceedings) can frequently be costly or even fatal to an effective reorganization. It is therefore important that the court be able to take advantage of any negotiations and work done prior to the commencement of reorganization proceedings under the insolvency law and that the insolvency law permits the court to expedite those reorganization proceedings.

3. Proceedings to recognize a reorganization plan negotiated and agreed out-of-court

367. Where an insolvency law provides for recognition of a plan negotiated and agreed before commencement of a reorganization proceeding under the insolvency law and also provides for expedition of that reorganization proceeding, consideration may need to be given to defining the debtors to whom it might apply and the parties that can be affected by such a proceeding.

(a) Eligible debtors

368. This type of proceeding may be available, for example, on the application of any debtor which is in a position of imminent insolvency but has not generally ceased making payments, in a position of temporary insolvency, or in a position where it can continue paying trade creditors in the ordinary course of business but has a moratorium agreed to allow for a reorganization of financial debt. Where the insolvency law establishes an obligation to commence insolvency proceedings where the debtor meets specified criteria concerning its financial position (e.g. that it has generally ceased making payments), it may be necessary to consider providing an exception for the type of proceeding described in this section or to provide a temporary moratorium which will enable the debtor to avoid meeting those criteria (and thus avoid the sanctions for failure to meet the obligation to apply for commencement). [Where there is a pre-petition plan negotiated and accepted between the debtor and creditors, there is no need to consider providing for a creditor application for commencement of such proceedings.]

(b) Obligations affected

369. As noted above, the types of obligations typically involved in out-of-court reorganization relate to borrowed money indebtedness, both institutional and public whether secured or unsecured, and other similar financial obligations. Secured debt would be included in such reorganizations with the agreement of the secured creditors. Indebtedness held by other creditors, such as trade creditors and employees would not generally be affected unless they individually agreed to adjustment of their claims. The specific obligations to be affected in any given case would be those identified in the plan which is to be enforced under this type of proceeding.

(c) Application of the insolvency law

370. In addition to identifying eligible debtors and determining who may apply for commencement of this type of proceeding, a regime providing for this type of proceeding will need to identify those provisions of the insolvency law applicable to full court-supervised proceedings that will apply to these proceedings, particularly if any changes are to be made in the manner in which they apply. So, for example, the provisions which would generally apply to this type of proceedings in the same manner as for full court-supervised proceedings (unless specifically modified) might include provisions on: application procedures; commencement; application of the stay; requirements for preparation of a list of all creditors (in order to inform the court, and provide notice and certainty as to who is affected by the plan and who is not); requirements for approval of the plan (including notice to affected creditors, determination of classes of creditors, creditor committees, criteria and majorities required for approval); effect and confirmation of the plan; and discharge of claims.

371. Provisions of the insolvency law that might not apply to this type of proceeding would include those relating to: the requirement for general cessation of payments or insolvency; appointment of the insolvency representative, unless there is provision for such an appointment in the plan; making of claims; requirements for notice and time periods for plan approval (where included in the insolvency law); and voting on the plan. A further and important exception to the application of the insolvency law would be that creditors not affected by the plan could continue during the proceedings to be paid in the ordinary course of business.

372. The application for commencement of this type of proceeding may need to be somewhat different to an application for full court-supervised proceedings to take account of the different background considerations. The application could include, for example, additional information concerning the negotiations that have already been conducted and the voting of affected classes of creditors, and the protection afforded to dissenting creditors within accepting classes. An insolvency law may also need to address the question of whether the application will function as an automatic commencement of the proceedings or whether the court will be required to consider the application; if court consideration is required it is desirable that the time for such consideration be as brief as possible.

(d) Expedition of the proceedings

373. In order to take full advantage of the agreement negotiated out-of-court and avoid the delays that may make that agreement impossible to implement, an insolvency law may need to consider how this type of proceeding can be handled more quickly than full court-supervised reorganization proceedings. [507/para. 244(a)] For example, if a plan and other

documentation that complies with the formal requirements of the insolvency law has been negotiated informally and is supported by a substantial majority, it may be possible for the court to order an immediate meeting or hearing as applicable, saving time and expense. [507/para. 244(b)] It may also be possible for an exemption to be granted from part of the formal process. For example, if an informally negotiated plan has been agreed by a sufficient majority of creditors of a particular class to approve a reorganization plan under the voting requirements of the insolvency law—typically the institutional creditors – and the rights of other creditors will not be impaired by the implementation of the plan, it might be possible for the court to order a meeting or hearing of that particular approving class of creditors only.

374. [507/para.244] Even though the insolvency law may provide for eligible cases to be treated expeditiously, it is highly desirable that it does not afford less protection for dissenting [non-assenting] creditors and other parties under such a procedure than the insolvency law provides for such dissenting creditors in full court-supervised reorganization proceedings. The procedural requirements for such (expedited) reorganization proceedings would therefore include substantially the same safeguards and protection as provided in full court-supervised reorganization proceedings.

375. [507/para. 244] Other laws may need to be modified to encourage or accommodate both out-of-court reorganization and this type of (expedited) reorganization proceedings. Examples of those laws might include those that require unanimous consent to adjust indebtedness outside of insolvency proceedings, that expose directors to liability for trading during the period when an out-of-court reorganization is being negotiated, that do not recognize obligations for credit extended during such a period or subject those obligations to avoidance provisions, and that restrict conversion of debt to equity.

Recommendations

Purpose of legislative provisions

The purpose of provisions relating to insolvency procedures which combine out-of-court negotiation <u>and acceptance of a reorganization plan</u> with an expedited procedure conducted under the insolvency law <u>for court approval of that plan</u> is to:

(a) Recognize that out-of-court reorganization, <u>which typically involves restructuring of the debt due to lenders and other institutional creditors, and major non-institutional creditors where their participation is crucial to the restructuring, but not involving all categories of creditors</u>, is a cost effective, efficient tool for the rescue of financially troubled businesses;

(b) Encourage and facilitate the use of out-of-court reorganization;

<u>(c) Develop a procedure under the insolvency law that will:</u>

(i) Preserve the benefits of out-of-court reorganization negotiations where a majority of each affected class of creditors [and equity holders] agree to a reorganization plan;

(ii) <u>Minimize time delays and expense and ensure that the agreement reached in out-of-court negotiations is not lost</u>;

(iii) Bind those minority members of each affected class of creditors [and equity holders] who do not accept the reorganization plan negotiated out-of-court;

(iv) Be based upon the same procedural requirements, but shortened time periods, as full reorganization proceedings under the insolvency law, including essentially the same safeguards for dissenting affected creditors;

(d) Recognize that requirements in other laws may prevent or inhibit the use of procedures which do not invoke the insolvency law, such as requirements for unanimous consent for adjustment of indebtedness outside of insolvency proceedings, liability for directors where the debtor continues to trade during the period when the out-of-court reorganization is being negotiated, that do not recognize obligations for credit extended during such a period, and that restrict conversion of debt to equity.

Content of legislative provisions

Commencement of (expedited) reorganization proceedings

(139) [(141)] ~~A debtor [which is eligible under the insolvency law] may file an application to commence expedited reorganization proceedings [to implement]~~ The insolvency law should provide that this type of proceeding is available on the application of any debtor [which is not a natural person] that will be unable to pay its debts as they mature (but has not generally ceased making payments) where a plan of reorganization has been negotiated and accepted by the vote of a majority of each affected class of creditors [and equity holders] and by each affected creditor not part of a voting class prior to the application to commence reorganization proceedings.

Application requirements

(140) [(142)] The insolvency law should provide that where the debtor can satisfy the requirements of recommendation (139) and the jurisdictional requirements for commencement of full reorganization proceedings under the insolvency law, the application for commencement of this type of proceeding should be accompanied by the following additional materials:

(a) The reorganization plan and [explanatory] [disclosure] statement;

(b) A description of the out-of-court reorganization activity that preceded the making of the application for commencement, including [evidence] that appropriate notice was given to all members of affected classes of creditors and that adequate information was provided to affected creditors [and equity holders] to enable them to make an informed decision about the plan [or a summary of that information];

(c) Certification that unaffected creditors are being paid in the ordinary course of business and that the plan does not modify or impair the rights or claims of [fiscal][tax] authorities or employees;

(d) A report of the votes of affected classes of creditors [and equity holders] demonstrating that those classes have accepted the reorganization plan by the majorities specified in the reorganization law;

(e) A report of the acceptance of any individual creditors which are not members of an affected class;

(f) A financial analysis prepared by [the debtor] [an independent expert] [or other evidence acceptable to the court] which demonstrates that the reorganization plan is feasible [and that dissenting creditors will receive at least as much as they would have received in a liquidation proceeding under the insolvency law]; and

(g) A list of the members of any creditor committees formed during the course of the out-of-court reorganization.

Effect of commencement

(141) [(143)] The insolvency law should provide that the application for commencement will [function as automatic commencement of proceedings] [be acted upon by the court as expeditiously as possible] and that:

(a) The effects of commencement should be limited to the debtor, individual creditors and classes of creditors [and equity holders] [those parties] whose rights are modified or who are affected by the plan;

(b) Any creditor committee formed during the course of the out-of-court reorganization should be treated as a creditor committee appointed under the insolvency law;

(c) Provisions of the insolvency law that apply to full reorganization proceedings shall also apply to this type of ~~expedited~~ reorganization proceeding unless identified as not being applicable;[2] and

(d) A hearing on the confirmation of the reorganization plan should be held as expeditiously as possible.

Notice of commencement

(142) [(144)] The insolvency law should provide that notice of the commencement of this type of reorganization proceeding should promptly be provided to all known creditors [and equity holders] and should indicate:

(a) The amount of each affected creditor's claim according to the debtor;

(b) The time period for submitting a claim in a different amount if the affected creditor disagrees with the debtor's statement of claim, and specify the place where the claim can be submitted; and

(c) The time and place for the hearing on confirmation of the reorganization plan, and for the submission of any objection to confirmation.

[2] Provisions of the insolvency law that would not be applicable would include: the requirement for insolvency of the debtor; full claim filing; notice and time periods for plan approval; mechanics of voting; no insolvency representative would be appointed unless required by the plan; provisions on amendment of the plan after confirmation; and […].
An exception to the insolvency law would be that creditors not affected by the reorganization plan would be paid in the ordinary course of business during the implementation of the plan.

Confirmation of the plan

(143) [(145)] The insolvency law should provide that the court ~~should~~ will confirm the reorganization plan where it determines that:

(a) The plan satisfies the requirements for confirmation of a plan in a full court-supervised ~~non-expedited~~ reorganization proceeding, in so far as those requirements apply to affected creditors [and equity holders];

(b) The notice given and the information provided to affected creditors [and equity holders] during the out-of-court reorganization was sufficient to enable them to make an informed decision about the plan [and any pre-commencement solicitation of acceptances to the plan complied with applicable non-insolvency law];

(c) The financial analysis submitted with the application is satisfactory and demonstrates that the reorganization plan is feasible [and that dissenting creditors [and equity holders] will receive as much under the reorganization plan as they would in a liquidation proceeding under the insolvency law];

(d) Unaffected creditors are being paid in the ordinary course of business and the plan does not modify or impair [rights] [claims] of [fiscal][tax] authorities or employees.

Effect of a confirmed plan

(144) The insolvency law should provide that the effect of a plan confirmed by the court under this type of reorganization proceeding should be limited to those creditors who took part in the negotiation and approval process.

Failure of implementation of the plan

(145) The insolvency law should provide that where the debtor fails to meet the obligations of the plan confirmed in accordance with recommendation (143), the plan should be terminated and creditors may exercise their rights at law, as modified by the plan.