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Draft legislative guide on secured transactions

Report of the Secretary-General

Addendum

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IX. Insolvency

A. General remarks

1. Introduction

1. In principle, the effectiveness and priority of a security right should be recognized and the economic value of the security right preserved in an insolvency proceeding. An insolvency regime, however, may modify the rights of secured creditors in order to implement broad social and economic policies (e.g. protecting unsecured creditors and workers). If an insolvency regime does so, creditors whose security rights might be modified may quantify this risk and incorporate it into their assessment of whether to extend credit and on what terms. Therefore, there are benefits for a State that wishes to encourage credit markets by means of a modern secured transactions regime in coordinating that regime with the insolvency regime. This chapter examines the relationship between the two regimes. It should be read together with the UNCITRAL Legislative Guide on Insolvency Law, which addresses the issues identified here in the broader context of insolvency law (see A/CN.9/WG.V/WP.63 and addenda). Conflict of laws issues arising with respect to security rights in insolvency proceedings are discussed in chapter X.

2. Secured transactions laws and insolvency laws have overlapping concerns and objectives. Both are concerned with debtor-creditor relations and both encourage credit discipline on the part of debtors. Both also share the objective of the recognition of security rights and the economic value of those rights. Effective regulation in either area will contribute to positive outcomes in the other. A secured transactions law, for example, may expand the availability of credit, thus facilitating the operation of a business and the avoidance of insolvency. A secured transactions law may also promote responsible behaviour on the part of both creditors and debtors by encouraging creditors to monitor the ability of debtors to perform their obligations, thereby discouraging over-indebtedness and consequent insolvency. Moreover, a secured transactions law that provides for a public record of security rights will make it easier for an insolvency administrator to promptly identify potential secured creditors (see A/CN.9/WG.VI/WP.9/Add.2, paras. …).

3. Nevertheless, there are tensions where secured transactions and insolvency law intersect because of the different approaches taken to discharging debts or other obligations. A secured transactions regime seeks to ensure that the value of the encumbered assets protects the secured creditor when the obligations owed to the secured creditor are not satisfied, while an insolvency regime deals with circumstances where obligations owing to all creditors cannot be satisfied in full. In addition, the former regime focuses on effective enforcement rights of individual creditors to maximize the likelihood that the obligations owed are performed or their economic value realized. The latter regime, on the other hand, seeks to maximize the return to all creditors by preventing a race between creditors to enforce individually their rights against their common debtor.

4. Legislators revising existing laws or introducing a new regime in the field of secured transactions might acknowledge these tensions by ensuring the reconciliation of proposed legislation with the existing or proposed insolvency regime. A modification to the rights of secured creditors through either regime

should be based on carefully articulated policies and be stated clearly and consistently in legislation, since reform in one regime can impose unforeseen transaction and compliance costs on stakeholders of the other regime.

2. Security rights in insolvency proceedings

5. Modern insolvency regimes generally provide for two main types of proceedings: liquidation and reorganization. In a liquidation proceeding, the insolvency representative gathers the insolvent debtor's assets, sells or otherwise disposes of them and distributes the proceeds to the insolvent debtor's creditors. Assets may be liquidated individually, either all at once or in stages, or as part of the business as a going concern. In the case of liquidation of individual assets in stages or as part of the business as a going concern, the insolvent debtor's business may have to be continued.

6. In a reorganization proceeding, on the other hand, the objective of the proceeding is to continue the insolvent debtor's business as a going concern if economically feasible, to capture for all the stakeholders the premium of the business's going concern value over its liquidation value (see paras. 42-47). Expedited reorganization proceedings are also evolving that encourage prompt judicial or administrative confirmation in a formal reorganization proceeding of an agreement reached by the principal creditors or classes of creditors before an insolvency proceeding commences (e.g., reorganization dealing only with certain classes of debt, such as financial debt; see paras. 48-51).

a. The inclusion of encumbered assets in the insolvency estate

7. An initial question is whether the encumbered assets are part of the "insolvency estate" created when insolvency proceedings are commenced against an insolvent debtor (see A/CN.9/WG.V/WP.63/Add.5, paras. 60-62 and 66, and Recommendation 27). The debtor or the third-party grantor may be "the insolvent debtor". [*Note to the Working Group: The definition of insolvent debtor in A/CN.9/WG.VI/WP.6/Add.1, para. 14, will have to be adjusted*.] When the debtor and the grantor are two different persons, in the case of the insolvency of the grantor, the assets are part of the estate and, in the case of the insolvency of the debtor, the assets of the third-party grantor that are in the possession of the debtor may be affected (see A/CN.9/WG.V/WP.63/Add.7, paras. 115-117 and recommendations 46-47).

8. Inclusion of encumbered assets within the insolvency estate can give rise to different effects. In many jurisdictions, inclusion of encumbered assets in the estate will limit a secured creditor's ability to enforce its security right (see para. 20). Any such legislative limitations on commercial agreements will be taken into account by creditors when deciding whether to extend credit to a debtor, and at what cost. Some insolvency laws that require all assets to be subject to insolvency proceedings in the first instance allow the separation of encumbered assets from the estate where there is proof of harm or prejudice to the economic value of the security right or where the particular assets are shown to be fully encumbered and unnecessary to the reorganization.

9. To allow for an assessment of whether the continuation of the proceedings will maximize the eventual return to all creditors, an insolvency law may subject the

encumbered assets to control within the insolvency proceedings. As a consequence, a secured creditor may be prohibited from taking possession of encumbered assets or, if it is in possession, may be required to surrender possession to the insolvency representative. This approach may be taken not only in reorganization proceedings, but also in liquidation proceedings in which the insolvent debtor's business is to continue while assets are liquidated in stages, or there is a likelihood that the business may be sold as a going concern. As it may not be possible to know at the commencement of insolvency proceedings whether it is desirable to continue the business, many insolvency regimes include the encumbered assets in the estate at least for a limited time period.

10. An insolvency estate will normally include all assets, tangible (movable or immovable) or intangible, in which the insolvent debtor has a right (ownership or other property or contractual right) at the time insolvency proceedings are commenced. What exactly is part of the estate may depend on whether an asset is encumbered or not, or is held subject to an executory contract with a third person, such as a contract of sale or lease. In any case, the asset or the contractual rights that the insolvent debtor has in relation to the encumbered assets will be part of the estate, and the net value of the asset or the contractual right should be the same (i.e. the value of the asset less the secured debt).

11. In those jurisdictions where transfers of title for security purposes are treated as title devices, even in the case of insolvency, the assets transferred by the insolvent debtor to the creditor are not part of the insolvency estate (see A/CN.9/WG.VI/WP.9/Add.1, para. 31). However, the price paid and any relating rights are part of the estate. In the jurisdictions where such transfers of title are treated as security devices, the assets are part of the insolvency estate (see A/CN.9/WG.VI/WP.9/Add.1, para. 32).

12. Whether retention of title is assimilated to a security right or not, the assets are not necessarily part of the insolvency estate. A jurisdiction may, for example, wish to protect suppliers or other purchase-money financiers from the claims of other creditors when the assets and affairs of their common debtor are liquidated in an insolvency proceeding. Even these jurisdictions might not extend this exclusion to reorganization proceedings because of an overriding policy objective of continuing potentially viable businesses.

13. Typically, a sales contract with a retention of title clause is treated as an executory contract. The insolvency representative may choose to pay the balance of the purchase price and to bring the assets into the estate or to avoid the contract and to claim the part of the price that was paid by the insolvent debtor. If the insolvency representative chooses not to pay, the seller can reclaim the assets as an owner or insist on the payment of the outstanding purchase price.

14. Where the value of the encumbered assets is greater than the secured claim, any surplus remaining after liquidation and payment of the secured claim is part of the estate. In the absence of insolvency, the secured creditor would have to account to the grantor for the surplus proceeds. If the same assets are disposed of during insolvency proceedings, the surplus would be available for distribution to other creditors.

15. With respect to the treatment of a surplus in the case of retention of title arrangements, legal systems differ. In some systems, the seller is entitled to retain

any surplus remaining after the sale of the asset and the satisfaction of the seller's claim, while in other legal systems the seller has to turn any surplus over to the insolvency estate. The issue might depend on whether such arrangements are treated as secured transactions or title devices and on whether the relevant contract is continued or terminated by the insolvency representative (see paras. 12-13).

16. The time and manner for determining the economic value of a security right may be provided for in insolvency law. A common approach is for the value to be determined at the time that the insolvency proceeding formally commences. [*Note to the Working Group: This matter is not covered in the Insolvency Guide*.] The manner for determining the value will ordinarily be related to the procedure for the recognition of the validity of claims against the insolvent debtor's estate (for the variety of possible mechanisms for the admission of claims, including secured claims, see A/CN.9/WG.V/WP.63/Add.13).

17. Outside insolvency, a security agreement may provide that a security right includes the proceeds of encumbered assets and after-acquired assets. An insolvency law may address the issue of whether the secured creditor continues to be entitled to these proceeds and assets acquired after the commencement of insolvency proceedings.

18. Proceeds received on the disposition of encumbered assets in effect are a substitute for those assets and, in principle, secure the economic value of the security right. Proceeds in the form of fruits and products of encumbered assets are not literally substitutes but represent natural increases which all parties expect to be subject to the security right. To the extent, however, that the insolvency representative incurs expenses in connection with these proceeds, the secured creditor rather than the estate should ultimately bear the burden of these expenses.

19. Assets acquired by the estate after the commencement of the insolvency proceedings in which the secured creditor might have a right outside insolvency are not substitutes of encumbered assets or the natural fruits or products of those assets. In the absence of new financing by the secured creditor, the case for recognizing the creditor's right in these new assets is less compelling.

b. Limitations on the enforcement of security rights

20. Upon commencement of insolvency proceedings, many insolvency laws impose a stay or moratorium on acts by creditors to enforce their claims or pursue any remedies or proceedings against the insolvent debtor. The stay may be imposed either automatically or at the discretion of a court, either on its own motion or on application of an interested party. A number of jurisdictions extend the stay to both unsecured and secured creditors. The same reasons for including encumbered assets within the estate apply to the stay of enforcement of security rights (see para. 8). Limitations, however, on a secured creditor's ability to enforce its security right may have an adverse impact on the cost and availability of credit. An insolvency law must balance these competing interests (see A/CN.9/WG.V/WP.63/Add.6, paras. 73, 75-78, 80-83, 84, 87, 91-92, 94 and 96-102, as well as recommendations 40-42).

21. If an insolvency proceeding commences only when the court decides on an application to commence insolvency proceedings, the court may be authorized to order protective measures to preserve the estate in the period between the

application and the court's decision on the application. The court might order these protective measures at its discretion, either on its own motion or on application of an interested party. Where these provisional measures are available they may include staying a secured creditor from taking possession of encumbered assets or otherwise enforcing its security right. Because these measures are provisional and are ordered before the decision to commence proceedings, creditors requesting these measures may be required by the court to provide evidence that the measure is necessary and, in some cases, some form of security for costs or damages that may be incurred.

22. The need to stay enforcement of a security right for a substantial period of time is less compelling in liquidation proceedings if assets are disposed individually rather than as a going concern. Different approaches may be adopted. For example, an insolvency regime may exclude secured creditors from the application of the stay, but encourage negotiations between the insolvent debtor and the creditors prior to commencement of the insolvency proceedings to achieve the best outcome for all parties. An alternative approach would provide that in insolvency proceedings the stay lapses after a brief prescribed period of time (e.g. 30 days) unless a court order is obtained, extending the stay on grounds specified in the insolvency law. These grounds might include a demonstration that there is a reasonable possibility the business will be sold as a going concern; this sale will maximize the value of the business; and secured creditors will not suffer unreasonable harm. Yet another approach is to leave the lifting of the stay to the discretion of the court supervising the insolvency proceedings but to provide statutory guidelines for the exercise of this discretion.

23. A stronger case for a stay is made when the insolvency proceeding is a reorganization proceeding. Removal of encumbered assets from the business will often defeat attempts to continue the business or to sell it as a going concern. Accordingly, an insolvency law might extend the application of a stay to secured creditors for the time period necessary for the formulation, approval and implementation of a reorganization plan (see A/CN.9/WG.V/WP.63/Add.6, para. 91).

24. If an enforcement action by a secured creditor is stayed, an insolvency regime should provide safeguards to protect the economic value of the security rights in the encumbered assets. Such safeguards might include court orders for cash payments for interest on the secured claim, payments to compensate for the depreciation of the encumbered assets, and extension of the security right to cover additional or substitute assets. The need for such safeguards is particularly compelling when the encumbered assets are perishable or consumable (such as cash or cash equivalents). The standard against which the safeguards might be assessed might be the position the secured creditor would have been in had it enforced its security prior to the commencement of insolvency proceedings.

25. In addition, an insolvency law might also relieve a secured creditor from the burden of a stay by authorizing the insolvency representative to release the encumbered assets to the secured creditor. Grounds for such a release might include: cases where the encumbered assets are of no value to the estate and are not essential for the sale or rehabilitation of the business; cases where it is not feasible or is overly burdensome to protect the value of the security right; and cases where the insolvency representative has failed in a timely fashion to sell or otherwise dispose

of the encumbered assets. An insolvency law might also provide that, once the stay has been terminated with respect to particular encumbered assets, the secured creditor could use, at its cost and if it wished, procedures in the insolvency proceeding to sell or otherwise dispose of the encumbered assets.

26. Where encumbered assets are necessary for the conduct of the insolvency proceedings, the insolvency representative may be entitled to use them, while providing protection of the value of the security right. In addition, the insolvency representative may be entitled to dispose of the encumbered assets free of any security right, provided that it notifies the secured creditor, the secured creditor is given the opportunity to object, no relief from the stay is granted and the priority of the secured creditor in the proceeds of the disposition is preserved (see A/CN.9/WG.VI/WP.63/Add.7, paras. 269, 278-280 and 292, as well as recommendations 44-45 and 51).

27. If the applicable secured transactions law authorizes the secured creditor to dispose of an asset outside insolvency, the question arises whether the secured creditor, rather than the insolvency representative, should control disposition of the relevant encumbered assets during insolvency. An insolvency law might provide that, in a liquidation procedure, the court may order that the encumbered assets be turned over to the secured creditor if the value of the encumbered assets is not sufficient to meet the secured obligation and there is a reasonable indication that the secured creditor would sell them more easily and at a better price. [*Note to the Working Group: This matter is addressed in more general terms in recommendation 42 contained in the Insolvency Guide*.] In any event, the insolvency law should make clear that any surplus after paying reasonable expenses and satisfying the secured claim should be returned to the insolvency estate.

c. Participation of secured creditors in insolvency proceedings

28. To the extent that encumbered assets are part of the insolvency estate and the rights of secured creditors are affected, secured creditors are given a right to participate effectively in the insolvency proceedings, including in any negotiations aimed at an amicable settlement. The extent of such participation is prescribed by insolvency law (see A/CN.9/WG.V/WP.63/Add.11, paras. 261-262, 269, 278-280 and 292, as well as recommendation 110). For example, secured creditors might participate in general creditor committees, eventually voting only on matters that affect encumbered assets, or in separate committees for secured creditors.

29. Where secured creditors rely on encumbered assets to pay all or part of their claims, the insolvency law might permit their participation in the proceedings to the extent that their claim is unsecured. Where secured creditors have surrendered their security right to the insolvency representative, the insolvency law might enable them to participate in the proceedings to the same extent as ordinary unsecured creditors. Where a secured creditor's claim is to be modified under a reorganization plan, the secured creditor might be entitled to participate in the reorganization proceedings.

d. The effectiveness of security rights and avoidance actions

30. In general, a security right that is effective against the insolvent debtor and third parties outside of insolvency should be recognized as effective in an

insolvency proceeding. However, a challenge to the effectiveness of a security right in insolvency proceedings is normally allowed on the same grounds that any other transaction might be challenged. The insolvency representative or the creditors may be authorized to seek to set aside ("avoid") or otherwise render ineffective any transactions intended to defeat, hinder or delay creditors ("fraudulent"), or preferential or undervalued transactions made by the insolvent debtor within a certain period before the commencement of insolvency proceedings (see A/CN.9/WG.V/WP.63/Add.9, para. 170 and recommendation 71).

31. The creation or transfer of a security right is a transfer of property subject to these general provisions, and if that transfer is fraudulent, preferential or undervalued, it may be avoided or otherwise rendered ineffective. This would mean that a security right, which is effective under the secured transaction regime of a jurisdiction, may be rendered ineffective, in certain circumstances, under the insolvency regime of the same jurisdiction. Therefore, there is a need for the grounds for such avoidance of a security right to be stated in clear and predictable terms.

32. In the case of liquidation proceedings, payment of proceeds of encumbered assets is not only allowed but also required, unless such payment is voidable under other applicable principles.

e. The relative priority of security rights

33. A secured transaction regime establishes the priority of claims to encumbered assets. Certainty with respect to priority is essential for the availability and the cost of credit. It is, therefore, important for insolvency law to respect the priority of security rights existing before the commencement of insolvency proceedings ("pre-insolvency priority"). Any exceptions to this principle should be limited, in number and value, and the existence and amount of these exceptions should be expressed in a transparent and predictable way (see A/CN.9/WG.V/WP.63/Add.14, paras. 423-425, and recommendation 168). For example, the exceptions might be set forth, not only in labour or tax law, but also in insolvency and secured transactions law.

34. An example of such an exception to the principle of respecting the pre-insolvency priority of security rights relates to privileged claims (e.g. unpaid wages, employee benefits or tax claims). While most legal systems award these claims priority only over unsecured claims, some legal systems extend the priority to rank ahead of even secured claims. Another example of such an exception arises where a portion of the estate, including encumbered assets, is set aside for the benefit of some classes of unsecured creditors, such as employees or classes of persons injured by acts of the insolvent debtor.

35. As a general rule, the value of the encumbered assets is not subject to a surcharge for the general administration of the insolvency proceedings. The insolvency representative may, however, incur costs in the maintenance of encumbered assets and pay for these costs from the insolvency estate. Because such expenditure preserves the economic value of the security right, not to grant priority over the secured creditor for these administrative expenses would unjustly enrich the secured creditor to the detriment of the unsecured creditors. To discourage unreasonable expenditure, however, an insolvency law might limit such priority to

the reasonable cost of foreseeable expenses that directly preserve or protect the encumbered assets.

f. Post-commencement financing

36. In order for an insolvency proceeding to yield the maximum return for all creditors, either through liquidation or reorganization, the insolvency representative must have sufficient funds available to it to fund the expenses of the liquidation or reorganization. In the case of liquidation, these expenses may include the cost of preserving and protecting the estate's assets pending their sale or other disposition. In the case of reorganization, the expenses may include payroll and other operating expenses to enable the insolvent debtor to carry on its business as a going concern during the insolvency proceeding.

37. In some cases, the insolvency representative may already have sufficient liquid assets to fund such anticipated expenses, in the form of cash or other assets that will be converted to cash (such as anticipated proceeds of receivables). However, these assets may already be subject to effective security rights held by the insolvent debtor's pre-existing creditors (such as a lender that has security rights in the insolvent debtor's receivables arising as proceeds from the sale of inventory). The use of such assets by the insolvency representative during the insolvency proceeding could well impair, or even destroy, the economic value of such security rights. As a result, an insolvency representative might only be permitted to use such assets in the insolvency proceeding to the extent that the rights of pre-existing secured creditors to receive the economic value of their security rights are protected. Otherwise, prospective secured creditors will be reluctant to extend credit to a (legal or natural) person knowing that, if that person were to become subject to an insolvency proceeding, they could lose the economic value of their security rights.

38. In other cases, the insolvency estate's existing liquid assets and anticipated cash flow may be insufficient to fund the expenses of the insolvency proceeding, and the insolvency representative must seek financing from third parties. Such financing may take the form of credit extended to the estate by suppliers of goods and services, or loans or other forms of credit extended by lenders. Often, these are the same suppliers and lenders that extended credit to the insolvent debtor prior to the insolvency proceeding. Typically, these providers of credit will only be willing to extend credit to an insolvency estate if they receive appropriate assurance (either in the form of a priority claim on, or security rights in, the assets of the estate) that they will be repaid. Yet here again, those assets may already be subject to effective security rights held by the insolvent debtor's pre-existing creditors and, for the reason described in the preceding paragraph, new creditors asked to extend credit to the insolvency estate are given a priority claim or security rights in the insolvent debtor's existing or future assets only to the extent that the economic value of any pre-existing security rights is protected.

39. Thus, in any of these financing arrangements (referred to collectively as "post-commencement financing") it is essential that the economic value of the security rights of pre-existing secured creditors is protected so that such creditors will not be unreasonably harmed. If encumbered assets are of a value significantly in excess of the amount of the obligations owed to pre-existing secured creditors, no special protection to the pre-existing secured creditors may be necessary initially (subject to the creditors' right to ask for protection at a later date if circumstances change).

However, in many cases such excess value does not exist, and the pre-existing secured creditors should receive protection to preserve the economic value of their security rights. Measures to protect this value might include periodic payments or security rights in additional assets in substitution for the assets used by the insolvency representative or encumbered in favour of a new lender.

40. When providing protection to a pre-existing secured creditor, it is important that such creditor not receive greater rights than it would have been entitled to if there were no post-commencement financing. Thus, the granting of additional security rights should not result in the pre-existing creditor improving its pre-insolvency secured position by, for example, securing unsecured pre-insolvency obligations. Rather, any additional security rights granted to a pre-existing secured creditor should secure only the insolvency estate's obligation to reimburse the secured creditor for the decline in value of the encumbered assets subject to its pre-existing security rights.

41. An insolvency law might incorporate specific provisions for post-commencement financing to indicate the circumstances in which such financing may be provided, the rules applicable thereto, and the effect of such financing on the rights of all parties. Such legislation could provide that post-commencement financing that affects the rights of pre-existing secured creditors may be extended only by court order, provided that appropriate notice, as well as the right to be heard, is given to all affected parties. By providing explicit rules, an insolvency law enables a creditor to consider the possibility of post-commencement financing when extending credit to a solvent debtor. Explicit legislative guidance provides greater transparency and predictability than a regime that merely permitted negotiated agreements between the new creditor and the insolvency representative (for further discussion of this topic, see A/CN.9/WG.V/WP.63/Add.14, paras. 416-420 and recommendations 162-165).

g. Reorganization proceedings

42. The principal objective of reorganization proceedings is to maximize the value of the insolvency estate in the interest of all stakeholders by formulating a plan for the business's rescue. In order to achieve this objective, it may be necessary for a secured creditor to participate in the reorganization proceeding, especially if the encumbered assets must be used in order to reorganize the insolvent debtor's business (see A/CN.9/WG.V/WP.63/Add.12, paras. 321, 325, 327, 329-334, 349 and 351).

43. An important corollary to requiring the secured creditor to participate in the reorganization, however, is that the secured creditor should not be made against its will worse off than if the secured creditor resorted to its non-insolvency enforcement rights to dispose of the encumbered assets and applied the proceeds of the disposition to the secured obligations. As a general proposition, the economic value of the secured creditor's security rights should be preserved and maintained in the reorganization. Otherwise, the uncertainty created by the inability of the secured creditor to rely upon receipt of the economic value of its security rights in the event of the reorganization of the insolvent debtor in an insolvency proceeding could result in the secured creditor not extending credit to the debtor in the first place or extending the credit at a higher cost. Moreover, such preservation of value is also

essential to attract the financing that the insolvent debtor will require in order to implement its reorganization plan and to operate as a rehabilitated enterprise.

44. If the secured creditor must participate in the reorganization, the proposed reorganization plan might contain provisions, which adversely affect its rights. The secured creditor may nevertheless agree to be bound by the reorganization plan. However, if the secured creditor does not agree to be bound by the reorganization plan, the question arises as to whether the reorganization plan may bind the secured creditor over the secured creditor's objection.

45. If insolvency law provides that a secured creditor may be bound by the reorganization plan over the secured creditor's objection, it should also preserve the basic protection that the economic value of the security rights should not be diminished under the plan without the consent of the secured creditor. At a minimum, the secured creditor should receive no less under the plan than it would have received in liquidation proceedings, unless it had consented to the reorganization plan. The protection of the secured creditor's security rights should be clear and transparent under the insolvency law so that the secured creditor will be able to make its decision as to whether to extend credit and, if so, on what terms, with the certainty of knowing that its security rights will be appropriately protected in the case of insolvency and if a reorganization plan were to be adopted over the objection of the secured creditor's class or, as the case may be, of the secured creditor itself.

46. There are several examples of ways in which the economic value of security rights may be preserved in the reorganization plan even though the security rights are being altered by the plan. If the plan provides that the secured creditor would receive a cash payment under the plan in exchange for the secured obligations, the cash payment should not be less than what the secured creditor would have received in litigation. If the plan provides for the secured creditor to release its security rights in some encumbered assets, the plan should provide for substitute assets of at least equal value to become subject to the secured creditor's security rights, unless the remaining encumbered assets have sufficient value to enable the secured creditor to be paid in full upon any disposition of the remaining encumbered assets. If the plan subordinates the secured creditor's rights to those of another secured creditor, the encumbered assets should have sufficient value to enable both the first-ranking and the subordinated secured creditors to be paid in full upon any disposition of the encumbered assets. If the plan provides for the amount of the secured obligations to be paid over time, the secured creditor should retain its security rights and the current value of the future payments of the secured obligations. In addition, the interest rate on the modified secured obligations should not be less than the amount that the secured creditor would have received in litigation. [*Note to the Working Group: The Working Group may wish to note that this matter is not addressed in the draft Insolvency Guide*.]

47. Whether the economic value of the secured creditor's security rights is preserved in a reorganization plan may be more of a factual issue rather than a legal issue in many circumstances. In the event of a contest in the insolvency proceeding as to whether the economic value of the security rights is being preserved under the plan, the determination of value will often require consideration of markets and market conditions. The valuation may, indeed, require expert testimony, especially if the treatment of the secured creditor under the plan involves encumbered assets

whose present value may be dependent upon the insolvent debtor's future performance and, therefore, may contain elements of performance risk to be factored into the determination of value. Absent agreement among the contesting parties, the court will have to decide on the evidence presented whether the economic value of the security rights is being preserved.

h. Expedited reorganization proceedings

48. In recent years, significant attention has been given to the development of expedited reorganization proceedings ("expedited proceedings") as a means of streamlining the reorganization of an insolvent debtor, without the cost or delay inherent in formal reorganization proceedings, in situations where all or substantially all of the insolvent debtor's major creditors (usually other than trade creditors) are able to reach an agreement as to the terms of the reorganization (see A/CN.9/WG.V/WP.63/Add.12, para. 369).

49. Expedited proceedings may take the form of a procedure in which: (i) the creditors first conduct negotiations concerning the terms of a proposed reorganization plan prior to the commencement of a formal insolvency proceeding; (ii) a formal insolvency proceeding is then commenced; and (iii) the reorganization plan is presented to the court for its approval on an expedited basis (but subject to the same requirements for disclosure to, and voting by, all of the insolvent debtor's creditors and other procedural requirements that are applicable in formal reorganization proceedings). When approved, the reorganization plan would bind dissenting creditors in the same manner as in a formal reorganization proceeding. Some proposals for expedited proceedings contemplate less involvement by the court, and rely primarily on agreements by the major creditors of the insolvent debtor, with resort to the court only for limited purposes.

50. From the perspective of promoting the availability of low-cost secured credit, it is essential that expedited proceedings not frustrate the reasonable expectations of secured creditors, or create a situation in which a secured creditor is worse off in such proceedings than it would be in a formal insolvency proceeding. Thus, for example, an expedited proceeding should not, without the secured creditor's consent, deprive that creditor of its ability to realize the full economic value of its encumbered assets, and should reasonably compensate the secured creditor for any diminution in that value resulting from the use of such assets by the insolvent debtor during the proceeding. Moreover, the expedited proceeding should not frustrate the reasonable expectations of the secured creditor under its credit documents and the applicable law with respect to choice of law or choice of forum.

51. As a general matter, the existence, in a given jurisdiction, of properly constructed expedited proceedings that adhere to the principles discussed above would encourage creditors to extend secured credit in that jurisdiction.

B. Summary and recommendations

52. In principle, encumbered assets should be included in the insolvency estate. If the underlying transaction is a title transaction (transfer of title or retention of title), the assets or the rights of the insolvent debtor relating to the assets should be part of the estate (see paras. 7-19).

53. Encumbered assets should be subject to the stay and other related limitations imposed. The insolvency law should specify the requirements, duration and the effects of the stay and related limitations, as well as the grounds for relief may be granted to secured creditors. In any case, the value of security rights should be sufficiently protected (see paras. 20-27).

54. If the rights of secured creditors are affected, the insolvency regime should enable them to participate in insolvency proceedings effectively to protect their rights (see paras. 28-29).

55. Subject to any avoidance actions, security rights created before the commencement of an insolvency proceeding should be equally effective in an insolvency proceeding (see paras. 30-32).

56. As a general rule, insolvency proceedings should not alter the priority of secured claims prevailing before the commencement of the insolvency proceedings. Certainty and transparency with respect to any necessary exceptions will help limit the negative impact on the availability and cost of credit (see paras. 33-35).

57. An insolvency law should incorporate specific provision for post-commencement financing so that a creditor extending credit before an insolvency proceeding is commenced may take into account the possibility of post-commencement financing before extending the credit (see paras. 36-41).

58. An insolvency law should enable secured creditors to participate in reorganization proceedings. The economic value of security rights should be preserved and, at a minimum secured creditors should receive no less than what they would have received in a liquidation proceeding (see paras. 42-47).

59. Expedited proceedings should not leave a secured creditor worse off than it would be in a formal insolvency proceeding, unless the secured creditor expressly consents (see paras. 48-51).